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NOMINATIONS OF RICHARD G. DARMAN AND RONALD A. PEARLMAN

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

NOMINATIONS OF

RICHARD G. DARMAN TO BE DEPUTY SECRETARY OF THE TREASURY

RONALD A PEARLMAN TO BE ASSISTANT SECRETARY OF THE TREASURY

JANUARY 29, 1985

Printed for the use of the Committee on Finance

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NOMINATIONS OF RICHARD G. DARMAN TO BE DEPUTY SECRETARY OF TREASURY AND RONALD A. PEARLMAN TO BE ASSISTANT SECRETARY OF TREASURY

TUESDAY, JANUARY 29, 1985

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m. in room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman) presiding.

Present: Senators Packwood, Roth, Danforth, Wallop, Grassley, Long, Bentsen, Matsunaga, Moynihan, Boren, Bradley, and Mitchell.

Also present: Senators Warner and Trible, of Virginia.

[The press release announcing the hearing and the prepared statement of Senator Dole follow:]

Press Release No. 85-102

PRESS RELEASE

FOR IMMEDIATE RELEASE
January 24, 1985

UNITED STATES SENATE
COMMITTEE ON FINANCE
SD-219 Dirksen Senate
Office Building

FINANCE COMMITTEE SETS DATES TO CONSIDER NOMINATION

Senator Bob Packwood (R.,Ore.), Chairman of the Committee on Finance, announced today that the Committee would conduct a hearing on Tuesday, January 29, 1985 on two nominations by President Reagan that have been referred to the Committee.

The hearing will commence at 10:00 a.m. in Room SD-215 of the Dirksen Senate Office Building.

The two nominees are:

1. Richard G. Darman, of Virginia, has been nominated to be Deputy Secretary of the Treasury. Since 1981, Mr. Darman has been Assistant to the President. From 1977 to 1981, he was an Officer and Member of the Faculty of Harvard University. From 1977 to 1980, Mr. Darman was a Principal with ICF Incorporated, a Washington based consulting firm. Prior to that time, Mr. Darman was Assistant Secretary of Commerce for Policy from 1976 to 1977; and a Fellow at the Woodrow Wilson International School for Scholars from January 1974 to April 1975. In 1973, Mr. Darman was Assistant to the Secretary of Defense and later that year held the position as Special Assistant to the Attorney General.

   Mr. Darman received a B.A. from Harvard College and M.B.A. from Harvard University Graduate School of Business Administration.

2. Ronald A. Pearlman, of Missouri, has been nominated to be Assistant Secretary of the Treasury. Since August 1984, Mr. Pearlman has been Acting Assistant Secretary for Tax Policy at the Department; and was previously Deputy Assistant Secretary for Tax Policy. From 1969 to 1983, Mr. Pearlman was a Partner in the firm of Thompson and Mitchell, located in St. Louis, Missouri; and an adjunct professor of law at Washington University School of Law in St. Louis. Mr. Pearlman was an Attorney-Adviser at the Internal Revenue Service from 1965 to 1969.

   Mr. Pearlman received a B.A. and J.D. from Northwestern University; and a L.L.M. from Georgetown University Law Center.

STATEMENT OF SENATOR DOLE

NOMINATIONS OF RICHARD G. DARMAN TO BE DEPUTY SECRETARY OF THE TREASURY AND RONALD A. PEARLMAN TO BE ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY

MR. CHAIRMAN--

I AM GLAD THAT YOU HAVE SCHEDULED THIS HEARING TO EXPEDITE SENATE CONSIDERATION--AND, I AM SURE, APPROVAL--OF TWO OUTSTANDING NOMINATIONS TO THE TREASURY DEPARTMENT. WE HOPE VERY SHORTLY TO COMPLETE SENATE ACTION ON THE NOMINATION OF JIM BAKER TO BECOME SECRETARY OF THE TREASURY, WHICH NOMINATION THIS COMMITTEE CLEARED LAST WEEK. WITH THE TWO NOMINATIONS NOW BEFORE US THE NEW TREASURY TEAM WILL BE OFF AND RUNNING. THEY NEED TO BE, BECAUSE THERE IS A LOT TO BE DONE.

RON PEARLMAN IS TO BECOME ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY. RON, OF COURSE, HAS BEEN ACTING IN THAT POST SINCE LAST AUGUST, AND IT IS GOOD THAT WE ARE FINALLY GETTING AROUND TO MAKE HIS POSITION OFFICIAL. THE MEMBERS OF THIS COMMITTEE HAVE WORKED CLOSELY WITH RON PEARLMAN SINCE 1983, ON TAX LEGISLATION AND ON REGULATORY MATTERS THAT HAVE COME UP IN THE TAX AREA. I AM SURE MY COLLEAGUES ON THE FINANCE COMMITTEE SHARE MY BELIEF THAT RON WILL BE A STRONG AND EFFECTIVE ADVOCATE FOR THE TREASURY IN THE UPCOMING TAX REFORM DEBATE. HE IS SOMEONE WE TRUST AND KNOW WE CAN WORK WITH.

NOT ONLY HAS RON PEARLMAN DEMONSTRATED HIS SKILL IN TAX POLICY AT THE TREASURY, HE HAS COMPILED A DISTINGUISHED RECORD AS A MEMBER OF THE TAX BAR IN ST. LOUIS AND A PROFESSOR OF TAX LAW AT WASHINGTON UNIVERSITY. I HOPE WE APPROVE MR. PEARLMAN'S NOMINATION WITHOUT DELAY.

RICHARD DARMAN

MR. PRESIDENT, RICHARD DARMAN HAS HAD LESS DIRECT INVOLVEMENT WITH THE MEMBERS OF THE FINANCE COMMITTEE, BUT WE ALL KNOW HIM AS THE VERY ABLE ASSISTANT TO THE PRESIDENT WHO, AMONG MANY OTHER RESPONSIBILITIES, WAS INSTRUMENTAL IN PUTTING FORTH THE PRESIDENT'S TAX AND BUDGET PROGRAM AND SECURING CONGRESSIONAL APPROVAL FOR THE "REAGAN REVOLUTION" IN ECONOMIC POLICY. SO HIS DUTIES AND OUR OWN HAVE OVERLAPPED VERY, VERY OFTEN IN THE PAST FOUR YEARS.

DICK DARMAN IS NOT JUST A BEHIND-THE-SCENES POLICYMAKER AND STRATEGIST: HE MADE AN EXCELLENT RECORD AS ASSISTANT SECRETARY OF COMMERCE UNDER PRESIDENT FORD, AND HE HAS HAD CONSIDERABLE EXPERIENCE IN BOTH THE PUBLIC AND PRIVATE SECTORS WITH ISSUES OF ECONOMIC POLICY AND INTERNATIONAL LEGAL QUESTIONS--A BACKGROUND THAT SHOULD SERVE HIM VERY WELL INDEED IN HIS NEW POST. I WELCOME MR. DARMAN TO THE COMMITTEE, AND I TRUST WE WILL HAVE MANY MORE OPPORTUNITIES TO WORK WITH HIM IN THE YEARS AHEAD.

MR. CHAIRMAN, I HOPE WE CAN SECURE SENATE APPROVAL OF BOTH THESE NOMINATIONS WITHOUT DELAY.

The CHAIRMAN. The committee will come to order. This morning we are going to hear testimony and ask questions of two nominees suggested by the President—Richard Darman, to be Deputy Secretary of the Treasury, and Ron Pearlman, to be Assistant Secretary for Tax Policy. I think that both of these men are well known to the committee members, Republicans and Democrats. Ron Pearlman, of course, is very, very well known to us as he has already served in a significant tax capacity for the past 4 years. And I think Dick Darman is known to us, not so much for his tax background, but certainly we have dealt with him in a variety of areas on other subjects in his capacity in the White House rather than in the Treasury Department. I think we have two Senators here to introduce Mr. Darman this morning. We will start with Senator Warner.

Senator WARNER. Thank you, Mr. Chairman, Senator Roth. This is a particular pleasure for me because I have had the privilege of knowing this fine gentleman for a decade and working with him off and on during that period of time in several capacities. Dick Darman, whom the President has nominated to become the Deputy Secretary of the Treasury, in my judgment is uniquely qualified for the position by virtue of his education and experience, not only experience in Government but experience in the private sector.

Since receiving his MBA from Harvard in 1967, he has served in senior policy positions in five Cabinet offices, and now this will be his sixth. At one time he was Assistant Secretary of Commerce, having received Senate confirmation. He has served as a principal and as a director of an economic and management consulting firm, as a member of the faculty of Harvard University Graduate School of Government.

In his present capacity as Deputy to the White House Chief of Staff, Mr. Darman has for the past 4 years coordinated the legislative and communications operations for the President. Indeed, he is the last stop for most of the written material that is passed on to our President. He has proven himself a keen negotiator and has taken an active role in the development and execution of most major economic initiatives coming from this administration. And I can say on personal experience, Mr. Chairman and members of the committee, that this fine American is uniquely qualified, of course, to take on this position, but he is a man of compassion, sensitivity, and toughness. He has a reputation for being short on occasions, but I think that is predicated on a knowledge and an ability to make decisions which will be necessary in his present position because, indeed, the fiscal issues facing this nation, as the Chair and members of the committee well know, are among the most serious.

So, without reservation, this nominee will have my unqualified support, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Trible.

Senator TRIBLE. Mr. Chairman, distinguished members of the committee. It is a great pleasure to join my colleague, John Warner, in presenting to you Richard Darman. Richard Darman has an impeccable academic background, as well as an impressive record of public service. He holds an A.B. and an M.B.A. from Harvard University, and he has held senior policy positions in five U.S. Cabinet posts—Health, Education, and Welfare, Defense, Justice,

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State, as well as having served as Assistant Secretary of Commerce for Policy. Currently, as we all know, he serves as Assistant to the President, a job in which virtually all of us have developed a working relationship with him, relationships that have been characterized by mutual respect. All these credentials, notable as they are, pale before one attribute—Mr. Darman is a resident of Virginia. [Laughter.]

Mr. Chairman, John Warner and I take great pleasure in and are honored to present to you Mr. Richard Darman, and we urge his prompt confirmation.

The CHAIRMAN. Mr. Darman, you come well recommended. I think you have a statement, and then I am sure we will have some questions.

Senator MITCHELL. If I can interrupt, Mr. Chairman?

The CHAIRMAN. Yes.

Senator MITCHELL. To hear Senators Warner and Trible, he sounds like he would be a heck of a candidate for the Senate. [Laughter.]

Do you agree with that, Paul?

Senator TRIBLE. Let's take it one step at a time. [Laughter.]

The CHAIRMAN. Mr. Darman?

STATEMENT OF RICHARD G. DARMAN, NOMINATED TO BE DEPUTY SECRETARY OF THE TREASURY

Mr. DARMAN. Mr. Chairman and distinguished members of the Senate Committee on Finance. It is a pleasure to appear before you today. I have a very brief opening statement.

[The prepared statement, a biographical sketch and a letter from U.S. Office of Government Ethics follow:]

STATEMENT OF

RICHARD G. DARMAN

BEFORE THE

SENATE COMMITTEE ON FINANCE

JANUARY 29, 1985

Mr. Chairman and distinguished members of the Senate Committee on Finance, it is a pleasure to appear before you today. I have a very brief opening statement.

I wish first to express my appreciation to Senators Warner and Trible. In the past decade and a half, as Virginia has become my adoptive home state, I have come to enjoy the benefit of representation in the United States Senate by these two extraordinarily able and dedicated public servants. Please let me thank them for their service -- and for their special kindness in introducing me to the Committee.

For the past four years, I have served in the White House as Assistant to the President of the United States and Deputy to the Chief of Staff. I appear before you today as the President's nominee to be Deputy Secretary of the Treasury.

If confirmed by the Senate, I would look forward to working cooperatively with the Congress as we seek to meet such challenges as: improving the tax system; controlling federal government spending; strengthening the international economic system; and advancing monetary policies that help assure strong economic growth without inflation. By meeting such challenges successfully, America will better be able to expand the benefits of opportunity and creativity both at home and abroad.

I would be happy to answer the Committee's questions with respect to these general objectives or any other matters of particular interest.

INFORMATION REQUESTED OF NOMINEE
(Richard G. Darman -- January 1985)

A. BIOGRAPHICAL:

1.	Name:	RICHARD GORDON DARMAN.
2.	Address:	1137 Crest Lane McLean, Virginia 22101.
3.	Date and place of birth:	May 10, 1943: Charlotte, North Carolina, USA.
4.	Marital status:	Married since September 1, 1967 to Kathleen EMMET Darman, Ph.D.
5.	Names and ages of children:	Two sons: William Temple Emmet Darman (born August 11, 1976); Jonathan Warren Emmet Darman (born February 6, 1981).
6.	Education:	General education: Harvard College (1960-64), B.A., cum laude, 1964; additional graduate study at Universities of Aix-en-Provence and Paris (1964-65) and Oxford, Boston, and Harvard (1967-70). Professional Education: Harvard University Graduate School of Business Administration (1965-67), M.B.A., 1967.
7.	Employment record:	Please see detail immediately below.

JANUARY 1981 - PRESENT:

ASSISTANT TO THE PRESIDENT OF THE UNITED STATES, The White House. Responsible for White House coordination of all staff work, briefing, and administrative support for the President. "Last stop" for all papers intended for the President or issued on behalf of the President. Coordinator, as Deputy to the Chief of Staff, of White House Legislative Strategy Group (1981-present), President's Budget Review Board (1982-present), and Budget "Core Group" (1984). Member, special White House-Congressional negotiating teams re Economic Program, Social Security, Saudi arms sales, Lebanon War Powers, and other such contentious legislative matters (1981-present). Participant, all meetings of National Security Council, Cabinet, and Senior White House staff. Member, U.S. Delegations to Industrialized Countries' Economic Summit meetings (1981-84). Overseer of Presidential Speechwriting and Research (1984-present). Member, Campaign Strategy Group (1984). Member, President's travelling party for all foreign trips and extended domestic trips.

JANUARY 1977 - JANUARY 1981:

HARVARD UNIVERSITY, Officer of the University and Member of the Faculty as Lecturer in Public Policy and Management, John F. Kennedy School of Government. Coordinator, "Government and Business" substantive area of concentration (1979-81). Developed and taught graduate courses in "Public Policy and Business" and "The Management of Federal Policy Development"; taught portions of selected research seminars, selected executive programs, graduate core curriculum course in public management, and Business-Government section of Harvard Business School's Advanced Management Program. Participated in design, initiated, and chaired faculty committee overseeing the development of "Harvard Program of Executive Sessions" (1978-81). Member of public management appointments committee (1978-81), standing committee on degrees in public policy (1978-81), ad hoc committee on research centers (1978), and research committee (1978-81).

AND SIMULTANEOUSLY (1977-1980):

PRINCIPAL, ICF INCORPORATED (1977-1980). ICF is a Washington-based firm specializing in analysis of economics and public policy. Professional staff exceeds 150. Clients include major U.S. corporations, government agencies, selected business associations and law firms. Personal consultancy was concentrated in: the relationship of business planning to emerging public policy issues, and investment in "new frontiers" (e.g., ocean resource development). Member, management committee.

Other Professional Activities In This Period:

Member, Council on Foreign Relations (1976-present), Washington Institute of Foreign Affairs (1978-80), U.S. Advisory Committee on Law of the Sea (1977-80), National Academy of Sciences' Ocean Policy Committee (1979-80); co-chairman, American Branch Committee on Law of the Sea, International Law Association (1978-80); and Chairman, NAS Panel on Ocean Energy and Mineral Resources (1980). Vice Chairman, United States delegation to the Third U.N. Conference on Law of the Sea (1977). Executive Director, The White House Transition (November 1980-January 1981).

FEBRUARY 1976 - JANUARY 1977:

ASSISTANT SECRETARY OF COMMERCE FOR POLICY, Washington, D.C. Confirmed as Assistant Secretary of Commerce by U.S. Senate. Principal policy adviser to the Secretary of Commerce responsible for overall management of all Departmental policy analysis, coordination, and development. Head of Office of Assistant Secretary for Policy comprised of staff of 300 including: (a) Bureau of International Economic Policy and Research; (b) Office of Policy Development and Coordination; (c) Office of Regulatory Economics and Policy; (d) Office of Energy and Strategic Resources Policy. Principal Departmental liaison with Economic Policy Board, Energy Resources Council, National Security Council. Co-chairman of Steering Committee, Cabinet Task Force on Questionable Corporate Payments Abroad. Chairman, NSC/EPB Task Force on Services and Multilateral Trade Negotiations. Co-Chairman, Commerce Regulatory Policy Council. Member: Deputies Group, Council on Wage and Price Stability; Deputies Group, Agricultural Policy Committee; ERC Steering Committees on Divestiture and on Nuclear Energy Policy; NSC/EPB Commodities Policy Coordinating Committee.

MAY 1975 - JANUARY 1976:

PRINCIPAL AND DIRECTOR, ICF INCORPORATED, Washington, D.C. (ICF was, in this period, principally a public policy consulting firm with offices in Washington, D.C., Palo Alto, California, and Raleigh, N.C. Its clients included government agencies and selected private corporations. ICF was also the sole owner of Health Development Corporation -- a new enterprise intended to invest in and develop health maintenance organizations.) Responsibilites were those of a general partner and director -- in both consulting and the overall management of the firm. Served also as consultant to Vice President of the United States, Nelson Rockefeller. Resigned to assume position as Assistant Secretary of Commerce.

JANAURY 1974 - APRIL 1975:

FELLOW, WOODROW WILSON INTERNATIONAL CENTER FOR SCHOLARS, The Smithsonian Institution, Washington, D.C. Developer and initial coordinator of Woodrow Wilson Center's Program in "State and Local Government: Problems and Prospects" -- focusing especially on issues related to federalism. Recipient of Woodrow Wilson Center stipend to support research on the recent fashioning of American domestic policy.

MAY 1973 - NOVEMBER 1973:

SPECIAL ASSISTANT TO THE ATTORNEY GENERAL (Policy Analysis and Planning), United States Department of Justice, Washington, D.C. Member of Immediate Office of the Attorney General responsible for coordination of Departmental staff work for the Attorney General in all areas of policy analysis, policy planning and management planning. Special adviser to the Attorney General on issues of high sensitivity, including the prosecution of the Vice President, the establishment of an inspector general, and events related to the "Saturday Night Massacre." Member of Attorney General's Committee on Election Reform; Attorney General's Committee on Inspector General; and Attorney General's Committee on the Management of the Department -- supervising design and preliminary implementation of plans for reorganization of the Department of Justice and the Development of integrated policy analysis-planning-management systems. Liaison with White House Domestic Council staff. Resigned October 20, 1973, on occasion of the "Saturday Night Massacre."

JANUARY 1973 - MAY 1973:

ASSISTANT TO THE SECRETARY OF DEFENSE (Systems Analysis/ Planning), The Pentagon, Washington, D.C. Member of Immediate Office of the Secretary responsible for coordination of staff work for the Secretary and Deputy Secretary of Defense in areas of weapon systems analysis, program budgeting, and management planning. Representative of Secretary of Defense in negotiations with Litton Industries and Grumman Aerospace Corporation related to major defense contracting problems. Advisor to Attorney General-designate Richardson on matters related to transition to the Department of Justice. Transferred to Department of Justice with Secretary Richardson.

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JULY 1971 - DECEMBER 1972:

SPECIAL ASSISTANT TO THE SECRETARY (Policy Formulation) and DEPUTY ASSISTANT SECRETARY (Planning and Evaluation), Department of Health, Education, and Welfare, Washington, D.C. Responsible for planning and evaluation, independent contract work, and all matters of policy analysis and development related to social service systems analysis, target group policy analysis (child development, youth development, rehabilitation, aging), manpower and labor market policy analysis. Responsible also for coordination of government-wide staff activites of Cabinet Committee on Aging. Member, steering committee for "Comprehensive HEW Management and Reform." Member, defense transition group -- transferred with Secretary Richardson.

Miscellaneous Other Experience:

Public policy analysis (1969-1971) through Harvard Center for Educational Policy Research, as consultant to Office of the Assistant Secretary for Planning and Evaluation (DHEW), as Special Assistant to Assistant Secretary for Planning and Evaluation (DHEW), and as member of Assistant Secretary for Administration's special task force on the management of DHEW. Management consultancy (while in graduate school) primarily with manufacturing companies. Personal Investment Management through: Thoor Ballyvernon Trust (1969-72); Johnson Products, Inc. (Director, 1972-75); and Charles Pratt and Co. (1968-75; 1977-80).

8. Government Experience: Please see response to (7) above.

Note: Experience is comprised of service as Assistant to the President of the United States (1981-85) and service in 5 Cabinet Departments (1970-77) -- including service as Assistant Secretary of Commerce for Policy (a Senate-confirmed appointment).

9. Memberships: Professional: Council on Foreign Relations (1976-present); Washington Institute of Foreign Affairs (1978-80); International Law Association, American Branch (1978-80); National Academy of Sciences' Ocean Policy Committee (1979-80); Board of Directors of Johnson Products, Inc. (1972-75), of ICF Incorporated (1975), and of SAGE Associates, Inc. (1978-79). Social: Owl Club, Pi Eta Club, Hasty Pudding Institue of 1770 (while at Harvard); Century Club, Public Affairs Forum (while at Harvard Business); Federal City Club (1975-80), and Metropolitan Club of Washington, D.C. (1978-present. Other: Trustee, Bennington College (1974-75).

10. Political memberships, offices, and financial contributions: NONE.

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11. Honors and Awards: Dean's List, Harvard College, 1960-64; Harvard B.A., cum laude; Century Club, Harvard Business School, 1966-67; Editor, Harvard Educational Review, 1969-70; Fellow, Woodrow Wilson International Center for Scholars, 1974-75.

12. Publications: Principal personal publications are as follows:

- R.G. Darman and L.E. Lynn, Jr., "The 'Business-Government Problem': Inherent Difficulties and Emerging Solutions," in John Dunlop, ed., Business and Public Policy (Harvard University Press: Cambridge, 1980).
- R.G. Darman, "Law of the Sea: Rethinking U.S. Interests," Foreign Affairs (January 1978). [Note: Variations of this basic argument were published in other contexts as well.]

NOTE: This necessarily omits official government reports and publications in which the author's contribution was but one among many largely anonymous contributions.

13. Speeches: None within the last 3 years other than remarks expressing or explaining Administration policy. (Note: no major speeches of any kind).

14. Qualifications: Qualifications include: (a) relevant professional academic training; (b) extensive related experience in five Cabinet Departments and the White House; (c) understanding of key issues affecting the private sector -- developed through the foregoing and through private academic and business pursuits; and (d) established and successful working relationships with key members of the Administration with whom the Deputy Secretary of the Treasury must interact.

United States of America
Office of Government Ethics

Office of Personnel Management
Washington, D.C. 20415

JAN 24 1985

Honorable Robert Packwood
Chairman, Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with the Ethics in Government Act of 1978, I enclose a copy of the financial disclosure report filed by Richard G. Darman, who has been nominated by President Reagan for the position of Deputy Secretary of the Department of the Treasury.

We have reviewed the report and have also obtained advice from the Department of the Treasury concerning any possible conflict in light of the Department's functions and the nominee's proposed duties. We call to your attention that Mr. Darman's wife established a qualified blind trust in 1981 pursuant to 5 U.S.C. App. 202(f)(3). Under the statutory scheme for this type of blind trust, an asset originally placed in the trust by Mrs. Darman is considered to remain Mr. Darman's financial interest for conflicts purposes until he has been notified by the trustee that the asset has been disposed of or has a value of less than $1,000. The trust becomes blind only as to assets subsequently purchased by the trustee. Because Mr. Darman is charged with having knowledge of the original assets that have remained in the trust, the Department and this Office have made those assets a part of this review. A descriptive list of those assets is attached for your information.

Based on the foregoing, we believe that Mr. Darman will be in compliance with applicable laws and regulations governing conflicts of interest.

Sincerely,

David H. Martin
Director

Enclosures (2)

Mr. DARMAN. I might first, if I could, express my appreciation to Senators Warner and Trible. In the past decade and a half, as Virginia has become my adoptive home State, I have come to enjoy the benefit of representation in the U.S. Senate by these two extraordinarily able and dedicated public servants. So, I should like to thank them for their service and also for their special kindness in introducing me to this committee.

For the past 4 years, as you know, I have served in the White House as Assistant to the President of the United States and Deputy to the Chief of Staff. I appear before you today as the President's nominee to be Deputy Secretary of the Treasury. If confirmed by the Senate, I would look forward to working cooperatively with this committee and the Congress as we seek to meet such challenges as improving the tax system, controlling Federal Government spending, strengthening the international economic system, and advancing monetary policies that help assure strong economic growth without inflation. By meeting such challenges successfully, America will better be able to expand the benefits of opportunity and creativity, both at home and abroad.

I would be happy to answer the committee's questions with respect to these general objectives or any other matters of particular interest. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Roth?

Senator ROTH. Thank you, Mr. Chairman. First, I would like to say I think we are very fortunate to have a man of your background and talents to be nominated for this most important position. I suspect that, like the Secretary of Treasury, you are going to have a very easy run of it, as you should have. I just have a couple of questions I would like to ask you, Mr. Darman. First of all, it seems to me that the most important objective that we should have in tax reform and the other measures that we take is to build an environment of long-term growth. I think the remarkable achievement of the first 4 years of the Reagan administration has been the total reversal in this country of an economy that was going down, people who were losing confidence in the system to a point where today people are optimistic about the future, and even the economists are rather cautiously optimistic as to what is going to happen short term. But one of my concerns is what was pointed out in the Wall Street Journal article a few days ago—that when people talk about reducing the Federal deficit, these are really code words for a tax increase. When people talk about, well, we are going to see what we can do on the spending side first, and then maybe we will look at tax revenue—it really means that ultimately the administration is going to come forward and support directly or indirectly a tax increase. Would you care to comment on that?

Mr. DARMAN. Yes, I would, Senator. First, may I thank you for your kind remarks at the beginning of your questioning. I certainly agree with you with respect to the overall objective of any comprehensive tax reform, and that is that it ought to be oriented principally towards economic growth. I might, if I could, however, just add a second objective which seems to me to be important and is reflected in the title of the Treasury study—and that is an objective of improving at least the sense of fairness with respect to the tax system as a whole.

It seems to me this second objective is important because, without it, there might otherwise be a sense of increasing cynicism with respect to the tax system and Government itself; and that would be unhealthy. So, I add the second, and I do so, believing that you would agree with that as well.

With respect to the interest in growth and productivity, I do think it important to emphasize that—as I know you also agree—incentives for savings are in part a key to the encouragement of growth, but also lowering marginal rates have a favorable effect as you, of course, the author of the Roth-Kemp bill, would argue perhaps better than most.

As for what I take to be the main portion of your question—is this interest in deficit reduction that many talk about an interest in proceeding with spending cuts first and then, at some later point, a tax increase, not tax reform—I can only repeat what Jim Baker said here and what the President has said to you and to other members of this committee and he has said publicly: in the President's rather direct phrase, "over his dead body." I personally don't sense at the moment a movement in Congress for a tax increase. If there were such a movement, I think it would be discouraged by the President simply repeating his very firm conviction on this point. I don't know what more one could add to it. As someone who has worked with him for the past 4 years on a daily basis, I can assure anyone who might have any doubts—and I suspect there are not many who would have doubts—that the President definitely means "over his dead body" when he hears talk about tax increases. He has said, as you know, that he would consider taxes as a last resort, as a means of closing the deficit, but he has argued clearly that he believes that tax increases would not only have an adverse economic effect but that tax increases would not, in fact, result in deficit reduction—partly as an economic matter but partly as a political matter. The prospect of tax increases would result in expenditures to consume the tax increases before there were any associated deficit reduction.

So, for a variety of reasons, the President is clearly opposed to a tax increase. But he has also stated that if it gets to a point when spending is reduced to the lowest possible level—the minimum level that Government must support for the services that society demands, provided on an efficient basis—and if at that point the revenue base were inadequate to equal the expenditure side of the equation, he would at that point consider a tax increase.

But whenever he has said that, he has added: "We are nowhere near that point at the present time," and I know you agree with that observation as well.

Senator ROTH. Let me ask you one more question, if I may, Mr. Chairman. Let's assume that Congress struggles mightily in trying to bring about spending reductions but finds it impossible to make any significant dent so that, at that time—and there are people in Congress that I think feel that the way to remedy the situation is to increase revenue—but the only way you can get any spending cuts is to combine it with a revenue increase. Would that meet the criteria? Or does the President, when he talks about as a last resort, mean that you have reached a certain percentage of gross national product, and that if it went beyond that, that he would

not consider a tax increase unless you had cut spending to a certain percentage of gross national product?

Mr. DARMAN. I think it is closer to the latter, Senator. What the President has said on this subject is that he does not mean to judge the point of last resort by the political behavior of the Congress. He means to make that judgment on the basis of what he takes to be a fair and informed calculation of what the proper cost of Government should be. So, to answer your question—the hypothetical question—if the Congress were to fail to enact sufficient spending cuts, I would predict that at that point the President would not say, well, that is minimum Government because the political system won't go lower. He would say no, here is why what I thought the first time is still correct, and he would attempt to explain that perspective and argue for it politically and not switch to the tax side.

On the question of linking taxes and spending, as we did do in 1982 and to an extent in 1984, I think the President feels he didn't get the better portion of the bargain, and he would like not to get involved in such trading this time around.

Senator ROTH. I agree with that. Let me just say that I think you are going to constantly be badgered on this question. When we walked out of the White House yesterday talking about tax reform, I had a number of reporters call me. And most of them kept emphasizing—down the road somewhere, aren't you going to have to raise revenues? So, I think you are going to have to keep repeating that.

The CHAIRMAN. I might say that in that meeting yesterday, though, I didn't hear anybody talk about wanting to raise taxes or even thinking about it. We argued about tax reform versus spending cuts and timing, but I don't recall even wanting to raise taxes.

Senator ROTH. I agree; at that meeting there was none, but I have to be honest and say in the cloakrooms individual Senators so speak.

The CHAIRMAN. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman. Mr. Darman, I join the other members of the committee in welcoming you and in saying that we look forward to working with you. I would simply add—pursuing the line of inquiry that Senator Roth had—that you referred to 1982 and 1984 as years in which the President signed into law tax increases. Don't forget 1983. The Social Security reform package included a tax increase as well. So in fact, the President has signed into law tax increases in 1982, 1983, and 1984. But I feel that we ought to pursue restraint in spending. [Interference noises.]

Senator DANFORTH. Is this the new regime? [Laughter.]

Senator MITCHELL. One Democratic Senator, and they have got it rigged so that he can't ask questions.

The CHAIRMAN. That is for those Senators who cannot hear the buzzer. [Laughter.]

Senator MITCHELL. I would like to conclude. I will be leaving, in fact, for the Environment and Public Works Committee where we will be pursuing some very aggressive actions to restrain spending in the jurisdiction of that committee, and I would hope that would

occur throughout the Federal budget—domestic, defense, and other areas.

I would like to change the subject and ask you, Mr. Darman, about the merchandise trade deficit. As you know, over the past 4 years the dollar has risen in value approximately 40 percent against the currencies of our major trading partners. This has caused the merchandise trade deficit to almost double between 1982 and 1983, to double again from 1983 to 1984, reaching a level of what now appears to be about $130 billion. Are you concerned about that, and what steps do you believe should be taken to deal with that problem?

Mr. DARMAN. Senator Mitchell, I thank you also for your welcome, and just before answering your question, add a footnote with respect to Social Security, which I know you would wish to have in the record, and that is that the Social Security compromise that was enacted in 1983 was indeed a bipartisan one, and the tax increase involved was essentially an acceleration of tax increases that were already in law.

With respect to your question concerning——

Senator MITCHELL. But of course, if you have a tax increase scheduled to go into effect in 5 years, and you move it up to 2 years, that is an increase for the period in which it is accelerated.

Mr. DARMAN. Yes, sir.

Senator MITCHELL. And it was a bipartisan effort, indeed, as was 1982 and 1984—all three were.

Mr. DARMAN. Right, and I might take the opportunity of suggesting that we would hope and expect that any tax simplification and reform in this year would be approached on a bipartisan basis as well. Indeed, we assume that that is the only way in which there is a prospect for enactment of a comprehensive law.

Senator MITCHELL. If I may interject, at that point, I personally agree with you. I may not be here when Mr. Pearlman comes on, so I want to say publicly here—I have said publicly many times—that I think the Treasury proposal is an outstanding effort; a first cut was a very difficult and complex problem. I saw this morning's paper—the smiling face of our chairman on the front page. I for one hope that you don't delay too long in submitting that to the Congress.

I think we accept Mr. Baker's statement at face value made before the committee here just last week in which he said that equal priority would be given to tax reform and deficit reduction, and it appears from the newspaper report this morning that tax reform isn't going to be quite as equal as deficit reduction. And I, for one, would hope that you would proceed. I do not agree with every provision in it, but I think it is an outstanding effort, dealing with an important problem. In your earlier comments, you made a correct statement to Senator Roth that if the Tax Code is too complex, people will think it is unfair. Let me tell you—they already do. I served as a U.S. attorney and personally prosecuted many income tax evasion cases. It is widespread in our society. It is a growing cancer. It is undermining respect for the law, and we must deal with it. And I hope you won't give it a back seat.

I have made it tough for you to answer the question, but go ahead.

Mr. DARMAN. If I may, Mr. Chairman, could I say a word about the last question of delay and then return to the trade deficit question? On the question of delay, Senator Mitchell, I am completely confident that Jim Baker's statements to this committee still stand and are fully supported by the President. I know that some members of your committee who were with the President yesterday would verify that. The news reporting was, as is sometimes the case, not completely balanced on this issue, and the "equal priority" statement of the President remains and indeed will be reaffirmed publicly in the near future. On the principal question you raised concerning the trade deficit and the strong dollar, you asked first are we concerned and, second, what would we do about it? What should be done about it?

On the question of concern, I might say it is a little bit a case of on the one hand and on the other. There are some favorable effects associated with the strong dollar and with imports. The favorable effects are obvious in that inflation is kept down, and to that extent, it makes our own environment somewhat more favorable for investment and growth. And, indeed, the strong dollar is a reflection, in important part, of investors' perception that the United States is a highly desirable place in which to invest at this time. So, to that extent, it seems to me, we shouldn't be disturbed about the strength of the dollar per se. A better way to look at it, I think—although it is the other side of the same coin—is in terms of the relative weakness of some of the other economies in the world economy. There are adverse effects, of course, with respect to U.S. exporters, and not least the agricultural sector and import-sensitive industries. But it seems to me the best way to go about dealing with this problem is not to try to talk the dollar down or try to intervene against a market trend, but to try to improve the prospects for growth in other regions of the world, working with our allies as best we can. As we do so, the growing strength of those economies would have two favorable effects. One, it would increase their imports of U.S. products, that is, it would increase our exports and thereby reduce the trade deficit. And second, as they become more attractive investment opportunities in their own right, it would to some extent decrease the strength of the dollar by virtue of its strengthening the attractiveness of investments in other currencies.

I think further it is useful to divide this problem into three broad regional subheadings. I think the problems are distinguishable. The European economies have one set of problems, grossly speaking here. The problems of developing countries are analytically separable, much more related to getting them viable in relation to their debt service. And the special problem that we have with respect to Japan is a third problem. And the type of solutions one has in mind for each, I think, ought necessarily to be tailored to the differing category of problem. It is this way of looking at things that I would take to an analysis of this area, and I think in doing so, I would be consistent with the administration's approach.

Senator MITCHELL. All right. Thank you very much, Mr. Darman. Thank you, Mr. Chairman. May I leave some questions in writing for Mr. Pearlman to be submitted to him?

The CHAIRMAN. By all means.

[Senator Mitchell's prepared questions follow:]

RESPONSES TO QUESTIONS FOR RON PEARLMAN FROM SENATOR MITCHELL

Question 1. It has been reported that the Treasury Department has been meeting over the last few weeks with representatives of various interest groups who are opposed to specific recommendations in the Treasury Department's tax reform plan.

First of all, let me ask you if you expect the President to endorse the Treasury tax reform plan in its present form?

What changes do you expect will be made?

Do you have any timetable for making such changes?

Answer. It would be premature for me to speculate on what aspects of the Treasury Department proposal the President will endorse. Given the multitude of controversial provisions in our proposal it would, however, seem highly unlikely that he would endorse the package in its present form. Of course, I cannot speculate on what changes will be made or when the President's proposals will be submitted.

Question 2. It was only four years ago that Congress passed legislation creating substantial incentives for capital investment through the Accelerated Cost Recovery System (ACRS). Now the Treasury tax plan would return to a depreciation system that more closely resembles pre-1981 law. In your opinion did Congress make a mistake in 1981 when it enacted ACRS?

Answer. First, let me make clear that our proposed system of depreciation allowances does not resemble pre-1981 law, which allowed no adjustment for inflation. Beyond that, one must consider the context in which ACRS was proposed and enacted. We had just gone through a decade characterized by high inflation rates that prevented business from being able to recover the real value of its depreciable assets before paying tax. The result was effective tax rates that in many instances far exceeded statutory rates, producing gross inequities and disincentives for capital formation. The response was to accelerate depreciation allowances in order that they might be taken before they were eroded by inflation. While superior to prior law, the current approach still leaves effective tax rates dependent on the rate of inflation and the composition of investment. We have proposed further improvement in which we substitute inflation adjustment of depreciation allowances for acceleration of allowances. The real cost recovery system we propose is roughly as generous as ACRS, but under it the value of depreciation allowances is independent of the inflation rate and effective tax rates are fairly uniform across types of assets and industries.

Question 3. The Treasury Department report on its tax reform proposal estimates that individual tax receipts will be 8.5% lower after the plan is fully phased-in. Meanwhile corporate receipts will be about 24% higher. Assuming changes are made in the Treasury plan before the White House sends it to Congress as a legislative initiative, do you expect those relative revenue effects to be preserved?

Does that indicate that Treasury believes corporate tax burdens are on average too low under current law?

Answer. It would be premature for me to speculate on what changes will be made in the Treasury plan before the White House sends it to the Congress as a legislative initiative. Therefore, it is impossible to know whether the shift in tax burdens you mention would be preserved.

This shift in burdens does not imply a Treasury position on whether or not corporate taxes are too high. Rather, it reflects the process by which decisions on tax reform and simplification were reached. We began by determining what structural changes were necessary in order to measure income more accurately, eliminate tax burdens on low-income families, maintain an acceptable spread between the corporate tax rate and the top individual rate, etc. Those decisions produced the shift of tax liabilities from individuals to corporations you mentioned.

Question 4. I support fundamental tax reform and believe that many of the Treasury Department recommendations have a lot of merit. We must restore taxpayer confidence in our federal tax system by making the Internal Revenue Code fairer and more easily understood. I realize however that those goals are not always consistent with each other.

In a perfect system it may be appropriate to adjust values for inflation as the Treasury proposal recommends with regard to depreciation, capital gains, FIFO inventory, cost depletion, and interest income deductions.

Are you concerned, however, that this indexation may actually add an element of complexity to the tax code that will frustrate taxpayers?

Answer. We are, of course, concerned with the complexity that would be introduced by indexation. We see the indexation provision as a kind of insurance policy. We do

not anticipate a level of inflation that would require inflation adjustment. But if inflation should reach its 1970s level, we would be prepared; taxpayers would not be forced to pay taxes on fictitious income, with consequent adverse effects on equity, neutrality, and capital formation. I would also note that the inflation adjustments would affect primarily corporations and individual taxpayers at the higher income levels, whose business and financial dealings are already fairly complicated. Most individuals would be little affected by the provisions for indexation because they do not realize capital gains or take depreciation allowances.

Question 5. Do you see any inconsistency in the Administration promoting a tax reform plan that would eliminate most of the deductions and credits in our tax laws while it simultaneously supports new tax expenditures in the form of tuition tax credits, enterprise zones, and spousal IRAs?

Answer. In our reform proposals we have suggested that most tax incentives be eliminated, but we have not proposed eliminating all of them. For example, we retain the deduction for mortgage interest on the principal residence of the taxpayer and preferential treatment of retirement saving. We propose an increase in the spousal IRA in order to reduce discrimination against those who work in the home and to reduce the existing disincentive toward saving and increase capital formation. The Administration believes that tuition tax credits and enterprise zones are justified under any type of tax system. Tuition tax credits will help give low and moderate income families a greater choice in educating their children. The enterprise zone proposal will help vitalize depressed inner city and rural areas.

The CHAIRMAN. Let me ask again, as I did with Mr. Baker last week. I was hoping that we could report these Members out. Would you mind reporting them out?

We are not going to rush them through this afternoon on the floor of the Senate, but we would like to report them out if we could.

Senator MITCHELL. I certainly would have no objection, and I am going to leave my proxy to vote for them.

The CHAIRMAN. Thank you. Senator Danforth.

Senator DANFORTH. Mr. Darman, I want to add my words to those of everyone else in congratulating you on this nomination and expressing my admiration for you and your extraordinary ability.

I have but one question, and that is to ask you, if you would, to elaborate on the following line that appears in your prepared statement.

You say, and I quote: "I would look forward to working cooperatively with the Congress." Could you spell out what you mean by that?

Mr. DARMAN. First, Senator Danforth, again may I thank you for your kind remarks in introducing your question. I really didn't have any profound thought in mind when that word "cooperatively" was scribbled. I hope you would agree that the way in which I have attempted to conduct myself over the past 4 years in the White House in a whole series of negotiations with the Congress—some through conventional means, some through special bipartisan negotiating groups—has been characteristically cooperative. And it is merely a continuation of that pattern that I had in mind. I didn't really mean to suggest that there was another alternative, if that is what you are concerned about. [Laughter.]

Senator DANFORTH. Thank you very much.

The CHAIRMAN. Senator Long.

Senator LONG. Thank you, Mr. Chairman. There has been some discussion here about the proposed tax measure. Am I correct when I say that the administration is still considering changes in that proposal?

Mr. DARMAN. Yes, sir, Senator Long. You are 100 percent correct.

Senator LONG. Having worked out a proposal down at Treasury, it has been made available to the President and his White House aides, and the matter is still under consideration as to just precisely what the President will recommend. Is it correct that as of now, changes are being considered?

Mr. DARMAN. Changes are being considered, and no change has yet been formally made because none of this has yet gone back to the President, but the President's expectation is that all of this—the judgment of key Members of Congress, the judgment of interested outside parties—that all of that will be brought back to him for further review before he determines exactly which proposals he would want to embrace and which he might wish to modify.

Senator LONG. I am all for tax simplification. I have voted for many measures, and I would be happy to support a lot of others, and I have even come up with some ideas myself to improve tax simplification, but I want to take a position somewhat at variance to Senator Mitchell's position with regard to the way we proceed with this measure.

I am against the so-called bum's rush approach to very important and significant legislation. Do you understand what I mean by that?

Mr. DARMAN. I believe I do, sir. [Laughter.]

Senator LONG. The expression comes from the old-fashioned bum's rush that they give a bum at the bar—you just give him the rush and throw him out on the street. [Laughter.]

Now, I don't want a situation where the Treasury has done its work on their tax program—and having done the best that they can do, they come charging up here and tell us we have got to pass this thing just the way they recommend it without any changes. Those fellows down at Treasury have got their ideas about a flat tax and a not-so-flat tax, and all the rest of it. They have kicked their ideas around for 1 year now, and after they get through making changes in the latest version, I don't want them to come down here and tell us: You have got to pass this thing tomorrow. That approach is something that I would have to object to, because somebody up here ought to take care of and look out for the interests of all those poor souls out there who might get the worst of it before this thing is all over with, and who have not had the opportunity to even see it or know just what it is. A Catholic nun from Louisiana came to see me the other day, and she is concerned about the charitable contributions deduction. One thing that public opinion polls are showing me, and they have been showing it all the time, is that as much as people are concerned about tax simplicity, they are even more concerned about tax fairness. Is that your impression?

Mr. DARMAN. Yes, sir; indeed, the polls suggest that much of the concern about simplicity is really a latent concern about fairness.

Senator LONG. Right. One thing all the polls show us is that people really don't think eliminating the deduction for charity is fair. The polls show that 82 percent of the people are concerned about the recommendation Treasury makes about charity. These polls show you what the public has been telling us for years, that if

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one person gives a lot of money to the charity and to education and to things that benefit society and less fortunate human beings in this world, and another person with the same amount of income gives nothing, they think the fellow who does a lot of charitable giving should not have to pay as much tax as the fellow who gives nothing.

Now, maybe you don't know about that yet, but if you don't, you will find out about it, Mr. Darman. I didn't have to talk to that nun to know how she was going to feel about that proposal. I have spoken with her before during the 36 years I have been here.

These sweeping proposals ought to be considered in the ordinary legislative process. I have been through many experiences down here, and there is none I find so irritating as to find that when something was going through that I didn't think was a good idea, somebody would try to shout me down and say he didn't have time to hear my point of view. The fact is that the overwhelming majority of the American people haven't had a chance to be consulted about any of these proposals, and we just think that in some cases it is going to be more appropriate to explain something to people where their perception may be in error.

May I proceed for just 1 more minute, Mr. Chairman?

The CHAIRMAN. Go ahead.

Senator LONG. Let me give you an example. Your proposal even now does not attempt to end the tax exemption for full faith and credit indentures issued by State and local governments, does it?

Mr. DARMAN. No, not completely; no, not at all.

Senator LONG. Fine; not at all.

Mr. DARMAN. It narrows it.

Senator LONG. Is it correct to say that insofar as the State and local governments issue a full faith and credit bond, it wouldn't be taxable at all under that proposal?

Mr. DARMAN. Right.

Senator LONG. If that provision stays in the law—and I personally happen to think it is unconstitutional to change it, based on the Supreme Court decisions up to this point—then we are still going to have people, if they invest in State and municipal bonds, who can make a lot of money and pay a small income tax. Is that correct?

Mr. DARMAN. Right.

Senator LONG. When Bill Simon was Secretary of the Treasury, he had once sold that kind of bonds. He made the statement that, from his point of view, they had been been taxed already. Can you understand the logic of that?

Mr. DARMAN. Yes, I can, Senator.

Senator LONG. His view was that investors in State and local bonds were accepting about 30 percent less revenue than they would get if they bought a taxable bond and that, to that extent, they made a contribution to State and local governments. It might be better to explain that matter to the public, rather than to say that we should amend the law to tax State and municipal bonds. We ought to consider everything that is involved in this. The public is entitled to have their say before we finally act on whatever proposal you want to send to us.

The CHAIRMAN. I remember Senator Boren is next, but I have just one comment. Do you recall in 1977 or 1978, when President Carter sent up a proposal, the Treasury had worked on it for some extensive period of time—and I can't remember who the Assistant Secretary was that testified—but he analogized it to one of those little round ball puzzles where all of the parts fit in exactly, and if you remove just one part, the whole thing falls apart. And we couldn't touch any of it or this very finely crafted program would fall apart. Indeed, we took out a piece or two——

[Laughter.]

The CHAIRMAN. And it fell apart. [Laughter.]

I don't want to unduly mislead you, but I think from what Senator Long has said and what you heard yesterday that, if you come with the idea that this finely tuned, finely honed program will rush through here with no changes at all, and with only a perfunctory hearing, you are operating under an illusion that simply isn't going to come to pass.

Mr. DARMAN. Senator, could I offer a couple of comments on this? It has been reported in the press that I was one of the people in the White House who was partially responsible for what was viewed as a lukewarm endorsement of the Treasury plan, and that reporting was accurate. And the reason is not unlike the reason that you have in mind here. The proposal was put together at Treasury. There was limited time for the President to see it, and it seemed at a minimum imprudent to embrace it in its entirety on very short notice. So, I believe what you saw is the President, just as a matter of prudence, putting some distance between himself and the Treasury plan initially, and he said, here it is, it is out in the public domain, and we invite criticism on the merits from anyone in any place.

With respect to your point about charitable contributions Senator Long, some of that criticism has also worked its way to the White House, and not just on that provision, but I would say on almost every provision in the bill. It seems to me that our problem here is not one of a possible bum's rush. The problem is that there might be no rush at all. [Laughter.]

And to repeat a comment I made earlier, what I think will be absolutely necessary is that we work together along the way—the administration and both sides, Democrat and Republican, in the Congress—to refine this proposal, to reshape it, to mutual satisfaction or else it won't ever go anywhere. And we think that there is enough of merit in the whole concept to merit a major effort to try to build concensus for what merits concensus. But exactly what may merit concensus in the end remains to be determined through a process we are really just beginning. So, I think we look at it very much in the same way that you would wish us to, and I think our behavior to date is really consistent with that point. I hope you might agree.

The CHAIRMAN. Senator Boren?

Senator BOREN. Thank you, Mr. Chairman. Before I ask questions of my own, Senator Symms has been held in a Transportation Committee meeting and just telephoned over to ask if I would put the question to you as to whether or not you will stay with the

President's position on gun control; if the President's position reflects your own view? I asked that on behalf of Senator Symms.

Mr. DARMAN. Thank you, Senator Boren. Yes, I have already assured Senator Symms that I am comfortable supporting the President's position on gun control, and I believe he himself is satisfied with that since he discussed it with me at some minor length, privately.

Senator BOREN. Very good. Thank you. While there has been some discussion of yesterday's meeting with the President, I gather, from what I heard just as I came in that not all the press reports were accurate about the meeting with the President yesterday. I am sorry to hear that. I thought that the report was a very encouraging one, that we were going to take up the deficit reduction first, which is so imperative, and not allow ourselves to get bogged down in a tax debate before we deal with reduction of the deficit. But let us assume—because the paper also reported that it could be 2 to 3 months, even if you give equal priority—and I realize you can give equal priority without putting them on the schedule timewise at exactly the same time. The committee can only take up one matter at a time, so I presume that there is going to have to be some decision made about scheduling.

I realize that the Secretary has already made a statement about retroactivity, but I wonder if the Department might look at that statement with even greater care. If there is going to be, let us say, even 1 month, or 2 months, or 3 months gap before the committee can even begin consideration of the tax proposals, we are already seeing a chilling effect in many areas of the economy where people are holding back on their investment decisions, and this concerns me.

We could create a downward spiral in many key industries just by the uncertainty that is created as we have discussed this. Even if we take up the tax bill right away, it is going to be several months before conclusion. Are you sensitive to this need to make sure that a strong statement is made about retroactivity so that investment decisions will not be withheld and that the process can continue and we won't cause an economic slowdown by the uncertainty?

Mr. DARMAN. Yes, Senator; I think we are sensitive to the problem. Secretary Regan made a statement, as you know, in December on the subject of retroactivity. It did not get much circulation. He suggested yesterday that had his name been misspelled with an extra "a" it might have received more circulation. So, at some point, it may be advisable to have the President make clear what the provisions are with respect to retroactivity. As you know, all of the provisions of the proposal as drafted by Treasury are prospective as it is. There are just varying points at which they would come into force. There are mixed reviews as to what effect this may be having on investment decisions at the moment. It may be that there is—and I know the arguments for this, I just don't have direct empirical data for it may be that there is some adverse effect, but one would expect that there would probably also be some offsetting favorable effects. In any case, we would look at this and try to clear it up.

Senator BOREN. I would hope that you would have some more discussions with those in various industries—and it is not in any one industry—where there seems to be a slowdown, and there seems to be some confusion yet about the retroactivity so that it could be made as clear as possible. And I am glad to hear you say that there is some consideration being given to urging the President himself to make a statement because I think that would be very, very helpful. Let me ask very quickly. The trade deficit came up a minute ago, and I heard Senator Mitchell question you about it. I am told that every time we run a trade deficit, that for every billion dollars we lose something like 25,000 to 30,000 jobs domestically, and I understand the concepts that you set forth—there is a Japanese problem, there is a broader problem in other geographical areas. If you were going to name one or two things that you think should be done—positive steps that should be taken to reduce this trade imbalance that is exporting our jobs—what do you think are the one or two most important steps that we could take to make improvements in this trade imbalance?

Mr. DARMAN. Consistent with the general approach I suggested earlier—of trying to assure increased growth and strength among other economies—I would continue the case-by-case approach to the management of the developing country debt problem, to work with the IMF to help get those economies get on more solid footing, because they are in fact substantial importers of U.S. exports, and that would be one element that would help with respect to our trade balance.

Similarly, with respect to OECD countries, their problem is not the same at all as the developing countries with respect to debt. Their problem is much more one that people at the Treasury like to call one of structural rigidities. It has to do with the way in which they manage their own economies. Obviously, we can't tell them how to manage their own economies. But I have participated in all four of the economic summits in which President Reagan has been involved, and it is my sense that there is a growing appreciation among other developed countries that they need to improve their market orientation as a positive incentive for their own domestic policies. As they do so and as they become stronger, they too can become stronger purchasers of U.S. goods. With respect to the Japanese, I think we need to operate in two directions—one with respect to financial markets. We need to continue to work with the Japanese to try to make the yen a more widely held international currency. That takes some strength away from the dollar to the extent that the yen-dollar relationship moves toward the yen.

And we need to open up Japanese markets. As you know, there is a special group that is working now on fairly large volume items—telecommunications items, and derivative forest product items, and so on--with the Japanese. To the extent that we can increase our exports to Japan, that will help.

All of these things together can have an effect on the dollar itself, and to the extent that other currencies rise in relation to the dollar, that will also improve the problem.

But I don't imagine any sudden change. In fact, I don't think a sudden change would be worth the price that would be associated

with it. But over time I think we can see some substantial improvement. It won't be overnight, Senator. I know you know that.

The CHAIRMAN. Would the record show that Senator Grassley and I ask unanimous consent that a statement of his be inserted in the record as if given.

[The prepared statement of Senator Grassley follows:]

STATEMENT OF SENATOR CHUCK GRASSLEY

Mr. Chairman: I would like to begin my remarks by offering publicly my congratulations to both the nominees. Mr. Darman, it is encouraging that a man of your experience in Washington and Administration politics will be devoting your talent to the important agenda of the Treasury Department. Mr. Pearlman, my experience of working with you over the past eighteen months has convinced me that it is possible for the Treasury, the IRS, and the members of this Committee to work together for solutions to our common concerns. I would like to acknowledge how appreciative I am of your consideration and responsiveness to my recommendations regarding IRS practices and procedures. If your newest position at the Treasury Department means you will be visiting capitol hill more frequently, perhaps we should arrange for a standing appointment.

As I have discussed privately with each of you, farmers and businessmen in Iowa are experiencing grave difficulties brought on by high interest rates and poor international exchange rates. Both of these problems can be traced directly to the high deficits in the last four years and the monetary policies of the Federal Reserve Board. I hope you will make it a priority to lend your support and encouragement to the effort to freeze federal spending, preferably across the board. I also hope that you will continue the effort of Secretary Regan to work with Chairman Volker for interest rate relief. Additionally, some tax reform may be essential in order to provide farmers with the relief of debt restructuring without the adverse income tax consequences.

As Chairman of the IRS Oversight Subcommittee, I look forward to working with you both, along with Commissioner Eggar to continued improvement of the IRS, in its dealings with individual taxpayers.

The CHAIRMAN. Senator Wallop.

Senator WALLOP. Thank you, Mr. Chairman. Just one quick followup on Senator Symms' question, and that is that the Reagan administration and the Treasury Department have redirected Treasury activities involving firearms from taking it away from law-abiding gunowners to an effort toward apprehending criminals with guns and lessening Government burdens on the law-abiding citizen. You expect that to continue, as I gathered from your response to Senator Boren.

Mr. DARMAN. Yes, I do definitely, Senator Wallop. As you know that is a very strong orientation of the President. I was asked earlier on behalf of Senator Symms whether I supported the President's position, and the President's position, as you know, rests basically on two points. One is constitutional with respect to the rights of individuals to bear arms, and the other is more practical and it has to do with the fact that regulatory schemes thought of to try to deal with the gun problem tend to put non-law-abiding citizens at an increased advantage relative to law-abiding citizens. And I think what you are referring to is an approach that is sensitive to both of those considerations and tries to protect the interests of law-abiding citizens while working on the problem of non-law-abiding citizens.

Senator WALLOP. And presumably the administration's support given in the last session for S. 914, the Firearms Owners Protection Act, would remain.

Mr. DARMAN. Yes, sir; I think that was Senator McClure's bill, and I believe it passed the Judiciary Committee unanimously, as amended, including the support of Senator Kennedy. And yes, our support for that bill continues.

Senator WALLOP. I thank you for that. Let me ask you, because we hear so much about it and so many different things, what in your opinion is the underlying reason for the strong dollar?

Mr. DARMAN. The strength of the U.S. economy relative to other economies in the world community.

Senator WALLOP. It has less to do with deficits and interest rates than it does with the strength of this economy relative to others?

Mr. DARMAN. In my opinion, the fundamental one is the one I stated, sir.

Senator WALLOP. I agree with that. I mean, I think just for starters if it were interest rates alone, the pound would be a great deal stronger, it having a higher prime rate now than the United States does. What then can be done about the strength of the dollar? I mean, surely we don't want to weaken this economy to make it come more in line with other currencies.

Mr. DARMAN. As I have tried to suggest, Senator, if one starts with the premise that the strong dollar problem is principally a function of the relative strength of the U.S. economy, and then one adds that one wouldn't want to weaken our own economy, one is almost led necessarily to what seems to me a perfectly reasonable direction in which to work and that is to try to help strengthen other economies. Now, there are limits on how much we can do, but that, I think, is the sensible direction. Everyone benefits that way.

Senator WALLOP. How do we do that? I heard what you said about the OECD. And clearly until they get some of the socialist overburden out from their statutory structure, there isn't a whole lot that we can do about that. For example, people are unable for economic reasons to lay people off from jobs that they have, and when you have the merging signs of economic strength, you have a reluctance on the part of employers to add to their employment for quite obvious reasons. What about the Third World? I mean, how do we go about strengthening them so that our trade relationships, vis-a-vis that large block of trading in the world, is improved?

Mr. DARMAN. The principal problem, it seems to me, is the excessive debt burden with selected Third World countries, and that is one that is being worked on well, I think, case by case. And I would hope many might agree that we have to give a certain amount of credit to the Treasury Department for its effort in the past few years in dealing with what might have been an extremely difficult problem, had it not been well managed. I think we wouldn't offer a whole lot different. A continued effort along the same lines. The problem hasn't gone away. It has merely subsided somewhat, but that problem is still there. There is a continuing need for reform of differing kinds within particular countries.

That has to be done with some considerable sensitivity so that it is not so draconian as to be counterproductive politically within those countries. There has to be bridge financing at times. There has to be some continuing bank support. But as those specific country situations improve and as the overall debt situation facing

them improves in aggregate, as their financial prospects improve, then one would see more dollar investment in those countries.

Now, the strong dollar isn't, as some people assume, exclusively a function of what people imagine as foreigners investing in the United States. To some extent that figure is a function of the fact that American dollar holders, in some substantial degree American banks, have stopped their prior pattern of investment abroad because of the risk associated with that investment, and they are holding dollars back here in what is a more promising environment.

So, slow but steady, as I said to Senator Boren. I wouldn't expect dramatic improvement overnight with respect to the adverse effects of this. And I do think, as you do, that it is worth noting that the effects aren't all bad. Some of the effects are good.

Senator WALLOP. Thank you.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I would especially like to welcome Mr. Darman to this new role in which, after 4 years in that "great white jail," has some real qualities. He will get to fly his own flag, and we are going to get to know him much better. Just for the record, with respect to questions of firearms, Mr. Darman, you referred to a constitutional right to bear arms?

Mr. DARMAN. Yes, sir.

Senator MOYNIHAN. Where is that right in the Constitution?

Mr. DARMAN. I don't remember the exact number, but the language is that the right of the citizen to bear arms shall not be infringed.

Senator MOYNIHAN. That language appears in the second amendment. But it refers to a well-regulated militia as being necessary to the security of a free State. There is not a respectable constitutional scholar in the country who thinks the second amendment refers to anything but the right of a State to maintain a militia, which does not mean that people may own guns.

Mr. DARMAN. Senator, I hope the record, as it exists now, will reflect the following as my prior statement. I was stating what I understood to be the President's basis of position, and I noted that it rested on two types of argument One—constitutional—and a second, practical. I am familiar with the debate as to the merits with respect to the constitutional argument. The practical argument, however, seems to me to be compelling regardless, although I must say I am not at all an expert in this area.

Senator MOYNIHAN. Why don't you become an expert and give us a statement on the constitutional issue. Will you do that? This is quite serious, because this is a question of what the Constitution says about guns. The Constitution has been thought to be important around here.

Mr. DARMAN. I have grave doubts as to what I might contribute to this already well argued debate, Senator, but——

Senator MOYNIHAN. You would contribute the vantage point of the Deputy Secretary of the Treasury.

Mr. DARMAN. On the constitutional issue?

Senator MOYNIHAN. The way you behave. It is at my request. Will you do that?

Mr. DARMAN. Oh, yes, absolutely, sir.

Senator MOYNIHAN. As the beginning of this administration's first term, it proposed to abolish the Bureau of Alcohol, Tobacco, and Firearms in the Treasury Department. Does this remain your view?

Mr. DARMAN. It is not the view of the administration, Senator.

Senator MOYNIHAN. They changed their mind?

Mr. DARMAN. I am not familiar with the history of the reorganization proposal in that area, but it would appear so if it is correct that it was proposed to abolish it.

Senator MOYNIHAN. Are you aware of the legislation that we almost adopted last year? It represented an agreement between the three branches of Government—the Executive, the Congress, and the National Rifle Association—which would have banned the manufacture and importation of armor-piercing bullets—so-called cop-killer bullets? Did you follow that at all?

Mr. DARMAN. No, I did not follow it. Indeed, almost everything I know on this subject I have learned in the last 36 to 48 hours, Senator, but I may say that, on the basis of a quick reading, it is my impression that that provision is covered in S. 914.

Senator MOYNIHAN. My question is this. The Treasury was curiously reluctant in this matter. Senator Thurmond, myself, and others put the bill in, but Treasury was reluctant. Do I take it you are not reluctant any more? Do you want to help work out a similar bill this year? We almost got one last year.

Mr. DARMAN. It is my understanding that we support that provision, but I don't know enough about the subtleties of this area to know what may explain the Treasury reluctance if there was some. I repeat, and it may be evident, that almost everything I know in this area I have learned in the last 36 to 48 hours.

Senator MOYNIHAN. But you are a quick study, as they say. Could I ask you one last question? With respect to the Treasury's proposal to eliminate the deduction for State and local taxes for purposes of calculating Federal income tax liability, I am not asking your opinion but would you concede the possibility that this provision could make it more difficult for a State or local government to incur higher levels of general expenditures than is the national norm?

Mr. DARMAN. It might have that effect, Senator, but not to the degree I think is sometimes presumed. For example, for the State of New York, there would be some increase in revenue for the State as a whole that would be associated with the fact that the State has a piggyback income tax system.

Senator MOYNIHAN. But that would simply mean a tax increase overall.

Mr. DARMAN. But there isn't an inherent reason why—if I understand your question correctly—why there must be a reduction in service.

Senator MOYNIHAN. My time is up. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Thank you very much, Mr. Chairman, and Mr. Darman, welcome to the committee. When I left Washington last weekend and went back to New Jersey, I felt fairly strongly that Secretary Baker would be fully committed to the issue of tax reform. In fact, he was very emphatic on that point in his testimo-

ny before the committee last week. And yet, I arrived in Washington today, and I see the Washington Post story which says: "The White House will delay submitting a tax simplification bill to Congress for several months." And then it says "Some administration officials have acknowledged that such slippage could cause delay of tax simplification until 1986."

[An article from the Washington Post dated January 28, 1985, follows:]

WASHINGTON POST
1/28/85 A1+A6

Treasury's Tax Proposal Supported by Majority

Existing Code Seen as Unfair, Poll Finds

By Barry Sussman
Washington Post Staff Writer

Americans support the Treasury Department's income tax simplification and revision plan by 2 to 1, according to a nationwide Washington Post-ABC News public opinion poll.

The poll suggests that much of the support comes from people who have little or no understanding of Treasury's modified flat tax plan but think that the tax system is so unjust that they would accept any changes aimed at making it fairer.

Dissatisfaction with the income tax system is so strong that, while a majority of the people interviewed say they think "taxes are just too high," four of every five say they would not complain about the amount they must pay if they thought the wealthy were paying a fair share.

Almost all the opposition to the plan, announced by Treasury Secretary Donald T. Regan in November, comes from people who say they think they would pay more in income taxes under it. But even among that group, one-third support the proposal.

Among people who say they think that they would pay less or the same amount in taxes, eight of every nine back the proposal.

Just over half the 1,505 people interviewed by The Post and ABC News said they had heard or read of the Treasury proposal. Among them, 63 percent favored it and 27 percent opposed it.

Of all those interviewed, including those unfamiliar with the proposal, 53 percent said they favor it, 26 percent said they opposed it and 21 percent expressed no opinion.

A minority, whether or not they had heard of the plan, said they think that it will be enacted by Congress without substantial changes.

The Treasury proposal would replace the present 14 tax rates with three, of 15 percent, 25 percent and 35 percent, depending on income. According to Regan, 80 percent of all taxpayers would pay less or the same amount in taxes.

Overall, the Treasury tax program would yield the same reve-

See POLL, A6, Col. 1

Treasury's Tax-Revision Plan Supported by Majority in Poll

POLL, From A1

nues as would current law, Regan said.

The main change would be the elimination of most deductions and exemptions, on the grounds that people of equal means should pay about the same amount in taxes and that investments by individuals and businesses should be made because they are considered worthwhile rather than because they would lead to tax reductions.

Regan's proposal would nominally lower the tax rate for corporations but in reality shift some of the burden from individuals to corporations.

Interest groups ranging from the real estate industry to charitable organizations have attacked aspects of the plan as harmful to them. The proposal, however, also has drawn praise from some tax specialists and citizens' groups, among others.

Congressional leaders, while agreeing that something should be done about tax equity, generally have been lukewarm about the plan. Senate Majority Leader Robert J. Dole (R-Kan.) said Thursday that the chance for action on tax simplification this year "is not so good."

As an eventual proposition, Dole said, it is "very much alive."

In the Post-ABC News poll, conducted Jan. 11 to Jan. 16, 34 percent of the people interviewed who had heard or read about the Treasury proposal said they think that they would pay more taxes if it were enacted, 14 percent said they would pay less and 44 percent said they would pay about the same amount, with 8 percent expressing no opinion.

About 40 percent of those interviewed with incomes of $20,000 a year or less said they think that they would have to pay more in taxes, although the Regan proposal calls for elimination of income taxes for people below the poverty level and for tax increases for about only 10 to 15 percent of families with incomes of $20,000 or less.

This shows that many people who have heard of the Treasury tax proposal seem to be unfamiliar with its content. Other findings suggest strongly that the core of support for the Regan plan comes from public distaste for the current tax system.

Asked whether they agree or disagree that "the present tax system benefits the rich and is unfair to the ordinary working man or woman," 72 percent said they agree.

On "whether nearly everyone who has the chance cheats somewhat on income taxes," 52 percent said they agree.

However, asked whether "it's no big deal" to underpay a little because "a lot of rich people pay no taxes at all," 24 percent agreed.

It seems, therefore, that the majority of Americans find tax cheating repugnant but feel that most people are cheating, quite possibly because they would think that they were being taken advantage of if they did not cheat.

On the question of whether "taxes are just too high," 61 percent agreed.

But the level of taxation seems less of a problem to most Americans than do inequities in the system. Eighty percent of those interviewed, and 84 percent of those who said taxes are too high, agreed that "I wouldn't complain about the amount I pay in taxes if I thought the rich were paying their fair share."

Senator BRADLEY. Now, I don't know if you have commented on that already in the course of this hearing, but is that the view of the administration? Is that your view?

Mr. DARMAN. The latter portion is not my view, and in my opinion is not the view of the administration. Nor is it necessarily the case, in my opinion, that any delay associated with the formal submission of a bill would necessarily be a delay for the process as a whole. Indeed, I am inclined to think that the next time the administration is seen formally on this subject with a proposal, it ought to be with a proposal that has a wider base of support than any now on the table. I suggest that as a matter of politics, not economics. And assuming that such a proposal could be developed in the next couple of months, the process might move along relatively well.

Senator BRADLEY. So, from your point of view on this Tuesday, there is no reason to change what the prospective Treasury Secretary said last week about the commitment to tax reform. Is that correct?

Mr. DARMAN. That is completely correct. And I think that you will find that the President supports that and will state it publicly, Senator Bradley. I think what you are seeing through the press, and it is entirely understandable, is many Senators are quite rightly, as the administration is, extremely concerned about getting action on the spending side of the balance, and for a variety of reasons they are fearful that too much attention to the tax side would either create opposition that would be unhealthful with respect to spending cuts, or create a presumption that there may be a tax increase which would remove pressure for spending cuts, or simply overload the system. And for that range of reasons, they are understandably inclined to wish to give emphasis to the spending side of the balance. Some are interested in the tax side, and there are some who are interested in both——

Senator BRADLEY. If I could, I would like you to at least consider another possibility, and I would like to share this with you in the form of a caution. And that is I think you have to beware of those people who try to subvert efforts for tax reform by saying that we have to solve the deficit problem first. Because, in my view, some of those who are promoting that sequence have an agenda that is not visible and that results in increased taxes. So I would hope that you recognize that that hidden agenda is to raise taxes without reform. And I really think that there is a form of debt hypnosis going on here, and what we have to do is keep our eye on tax reform because if you get any increase in taxes on the already unfair tax system, you only increase the unfairness. Do you not agree with that?

Mr. DARMAN. Yes, I agree, Senator Bradley. Before you arrived, Senator Roth expressed a similar concern and reported on something I obviously cannot be directly familiar with, but he suggested that he had heard cloakroom conversation which would confirm what is your hypothesis. In any case, that is not the administration's interest. We are not interested in a tax increase. We are interested in moving under both headings as expeditiously as possible, and while we specifically do not want them to be joined, we do

not think that one needs necessarily wait at one stage or another for the other. Each will move on its own track as fast as it can.

Senator BRADLEY. We know that the special interests are organized and that they will try to frighten people by telling them what they are going to lose, without ever telling them that they are going to get lower rates of tax in exchange. And they are betting that the media isn't going to tell people that tax reform means lower rates of tax. What would you say we could look for from the administration in the near term to demonstrate its commitment to show this choice to the American people—the choice of lower rates and fewer loopholes or the present system with high rates and a lot of loopholes?

Mr. DARMAN. I would hope that, at least at a general level, the President would speak to this in the state of the Union, Senator Bradley. And I would hope that at the stage when we have a wider base of concensus around whatever modified proposal is the basis on which a substantial number of Democrats, and Republicans, and the administration are prepared to go forward, at that point—and we can't say exactly when it would be—I would expect to see the President visibly associated with this initiative and using such communications skills as he has on behalf of this initiative, just as he has on others that are high priority for him and for his Presidency.

Senator BRADLEY. Mr. Chairman, may I submit to the record an article in the Washington Post on January 28, 1985, that is a story about a poll taken by the Washington Post, ABC News, in which by a margin of 2 to 1 the American people in this poll supported the Treasury proposal for tax reform.

The CHAIRMAN. I am curious, Bill. Is that the poll where the sort of question asked is: "Are you in favor of simplification and fairness?"

Senator BRADLEY. No; I think that you find in this poll, as well as in many of the polls—as I think many Members of the House and certainly I have found—that when you confront people with the choice of what they are going to have to give up, and you tell them that they are going to get a lower rate for the long run, they are willing to give those things up. So, this poll maybe didn't do it in as great a detail as I have and other people have done in their town meetings, but in my view it clearly laid out the choice, and the people chose 2 to 1 lower tax rates over this complicated, unfair income tax system that we have today.

The CHAIRMAN. I don't know if you were here earlier when Senator Long laid out at least one of the questions that was in the New York Times poll 1 week or 10 days ago where they asked more specific questions. What was it you said, Russell, about charitable contributions? How many were opposed to changing that?

Senator LONG. They asked people what their position was on the elimination of the charitable contribution. The poll showed 82 percent against it and I think 16 percent for it. That is not a very strong endorsement, but it is a recommendation.

Senator BRADLEY. If we are going to get specific, I wonder how they would have answered it if the question was: "Would you be in favor of limiting the charitable contribution for the top 10 percent

of the population in exchange for a very low tax rate for you?" You know there are all ways to ask and answer these questions.

Senator LONG. Generally speaking, I can tell you the answer. As long as it cuts their tax, they are going to be for it. If it cuts the other guy's tax, they are going to be against it. That is how it always comes in.

The CHAIRMAN. I want to put to rest this hidden tax idea. I don't know where the suggestion comes from. The first time I heard it was in former Vice President Mondale's acceptance speech, where he talked about the Republicans or the President having a hidden tax agenda. If it is hidden, it is really hidden. I haven't heard of it yet. I haven't seen it yet. I have been at meetings at the White House. I haven't heard the President wink, blink, smile, or anything else when anybody talked about some hidden tax agenda.

He is not interested in VAT taxes, or flat taxes, or fun taxes, or VAST taxes, or any other kind of taxes, the best I can tell, and the only time I hear the suggestion mentioned very often about needing more taxes comes from the Democratic side rather than the Republican side. And all I hear, if that suggestion comes up from the Republican side, is no, or at the most, if there must be some kind of taxes, what should the form be? But the request for more taxes is not coming from the President. It is not coming from any of the Republicans that I know of. I want you to ask you, Mr. Darman, because I passed on my first round of questions, exactly what went on at that meeting yesterday. And I will paraphrase it, and you tell me if I am wrong. It was a meeting of the President and of the Republican members of the Finance Committee and the Ways and Means Committee.

And more or less, we went around the table, everybody commenting as to what they wanted to comment. I do not recall a single comment that said other than we wanted to consider spending cuts first. We wanted to cut spending, cut spending, cut spending, before we considered taxes, whether it was tax reform or tax increases. Does that roughly phrase it right?

Mr. DARMAN. I was out of the room for about 5 minutes out of the 45 minutes to an hour, Senator, but for the time that I was in the room, that certainly is a fair characterization.

The CHAIRMAN. Now, second, there was a fair degree of support for the philosophy of the President's tax reform package—the philosophy of it, the simplification, the lowering of the rates. It had a fair degree of support. Some people had some questions about some portions of it. Senator Long has expressed some questions. I think Senator Boren has expressed some questions about some parts of it. But, no, oh well, kind of wink and pretend we want to delay it and we will never consider it again. I want to consider it, and we are going to consider it, but I don't sense any overwhelming support to go forward with it until we have at least addressed ourselves to spending cuts. And I thought Senator Armstrong phrased it as well as anybody yesterday when he said that many of the allies we are going to need for the spending cuts are going to be enemies on the tax reform package, and we had better not irritate or agitate them initially while we need their support because, as soon as the tax reform package is introduced, that is going to draw their primary attention. And if that is a political decision, so be it. I think it is

more important that we attempt to cut spending—and we may fail—the votes may not be there when we finally sit down, Republican and Democrat, and say where we can cut, we may not have the votes. I hope we do, but I want to assure the Senator from New Jersey there is no intention, at least in this committee, to so far drag out, or delay or deny hearings on so-called tax reform, although I am ready to join Senator Long on his bill to prohibit the use of the word "reform" in any tax bill ever again. I think there is much merit, Russell, in that idea. But we will have the hearings. Now, I want to ask you one other thing, and you can defer to Assistant Secretary Pearlman if you want. This is a memo of August 6, 1984, so it is now a bit out of date, specifying the number and percentage of taxpayers that use different forms. And certainly a 1040EZ, a 1040A, and a 1040 with no itemizations would normally be called relatively simple forms. Would they not?

Mr. DARMAN. Yes, sir.

The CHAIRMAN. All right; 16 percent of the taxpayers use the 1040EZ. The only thing you can take on a 1040EZ is the charitable deduction above the line period. You can't take anything else. There are only six credits or deductions you can take on a 1040A. On a 1040 you can itemize, but 27 percent of the people don't bother to itemize. So, you have got 16 percent that file a 1040EZ, 22 percent that file a 1040A, and 27 percent that file a 1040 with no itemizations. That is roughly two-thirds of all the taxpayers in the country who, by any stretch of the imagination, file what is known as a simple form. Correct?

Mr. DARMAN. That is roughly correct, as I understand the numbers, Senator.

The CHAIRMAN. I may be off a percent or two because these are 1982 figures, but my hunch is I am not very far off for the returns that were filed in 1983 and for the ones that will be filed for 1984. And I will restate again what so struck me when Mr. Block—Henry Block—testified a number of years ago, which I have since verified with him in conversations in the last 2 weeks. This is Mr. Block of H&R Block, and he is clearly interested in what people think about taxes and tax forms and tax deductions. He testified here in 1979, and he said—he polled the question of tax simplification and asked: Are you in favor of tax simplification? And he found an overwhelming support for it. He then discovered that what people meant when they answered the question was fairness and not simplification. And when he repolled the question and made it very clear that what he was asking about: Does your tax form need to be made simpler? Is that a major issue to you? He found less than 5 percent had any concern with simplification just for the sake of simplification. And I hope when we start down this road of tax reform—and I guess that is what we are going to call it again—that we don't attempt to drive it with the engine of tax simplification and to push through or roll over serious objections using the argument of simplification, when what most people want is fairness.

Mr. DARMAN. Mr. Chairman, could I offer comments with respect to two different subjects you raised?

The CHAIRMAN. Yes.

Mr. DARMAN. With respect to the latter first, at the start this morning, Senator Roth asked if I agreed that the overriding objective of any comprehensive tax restructuring or reform, or simplification—whatever we want to call it—should be growth, and I said yes. But I added a second important objective and that was improving the perception of the system's fairness. I said the perception of the system's fairness, and I think I am agreeing with you in suggesting that improving simplification in some cases may be consistent with increased fairness and some cases may not, but improving simplification can be a way to improve the perception of the system's fairness because, while it is true that something like two-thirds of the people have a relatively simple interaction with the IRS themselves, I believe polls show that the presumption of an overwhelming majority of those people is that a large number of other people are unfairly benefiting from the complexity of the system of which they themselves may not avail themselves.

The CHAIRMAN. If all you did was simplify it, these same two-thirds that have a relatively simple form now would not have any better perception of fairness, if you didn't make any other changes.

Mr. DARMAN. No, to the extent that those people are led to believe that other people are obliged to conform with some readily comprehensible system, which assures that those other people—not the two-thirds, those other people—will be paying something like their fair share, to the extent that simplification contributes to that perception, it is increasing the overall perception of the fairness of the system. Now, it is arguable which types of provisions do that and which don't, but I think as a general matter that that is right.

Could I offer a comment with respect to a second matter?

The CHAIRMAN. Yes.

Mr. DARMAN. The second subject you raised—the one you raised first. I obviously cannot speak for the Members of Congress who were at the meeting you referred to yesterday with the President, but I would like to clarify one more time—or attempt to—what I think is our perception on this question of which first, which second. We agree that as a practical matter for a variety of reasons the spending cut portion of the overall economic program must move first legislatively, but that is not necessarily to say that everything with respect to the subject we are now talking about must be on hold until there is some spending bill, a spending reform measure of some kind or other enacted. If we hold that as a guide to the schedule, we could be waiting to discuss these tax issues until the fight over the continuing resolution in the latter portion of this year. What I think we are suggesting is that the spending side will have very specific proposals from the President in the budget. Those we would hope would be promptly reviewed and acted upon by the Congress. But at the same time, we would be moving to develop—with somewhat of a lag but not a large lag—equally specific proposals with respect to the tax side, and we would hope that the next time the administration is seen on this subject it would be, as I suggested, in a manner that enjoys a fairly wide base of bipartisan support. And at that point, it seems to us at least, there could well be hearings on whatever may have been agreed to by those involved, and the process can at least be moving

within the next few months, not awaiting final action on the spending side. I hope that is a clarification that is consistent with your own view.

The CHAIRMAN. We have a second round of questions although I might remind the members we have Mr. Pearlman also to consider, and I would like to finish them both today if we can. Senator Roth?

Senator ROTH. No.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. No.

The CHAIRMAN. Senator Long?

Senator LONG. No, Mr. Chairman.

The CHAIRMAN. Senator Boren?

Senator BOREN. Mr. Darman, do you feel that an element of risk—the element of risk—that is involved in a particular financial enterprise is an element that appropriately should be considered when we are determining fairness in the Tax Code? I have heard it argued that if we tax all kinds of incomes at the very same rate without any consideration being given to the element of risk involved, that it will sap the vitality of the system by discouraging investment in new enterprises, for example. If we had not had cuts in the capital gains, we would not have had the great expansion of venture capital, for example. Do you agree or disagree with the consideration of the element of risk in determining what constitutes sound and fair tax policy?

Mr. DARMAN. I do agree that there needs to be some consideration of the element of risk, but I thought I ought to qualify that statement rather considerably. My personal preference, and it is one reflected in the Treasury proposal, is toward a prejudice in favor of neutrality with the burden on those to show why one should deviate from economic neutrality. And I don't believe that it would be sufficient showing to say merely that such-and-such an activity is high risk. I think the economic system will make its judgments, by and large, in a satisfactory way with respect to adjustments for one type of risk or another that are reflected in the likely returns associated with investment—higher returns for higher risk, as a general matter. But there may be cases—and I know there is at least one whole sector that is such a case that is of some considerable interest to you and to the Nation—in which there would, from an overall public-good standpoint, be underinvestment.

A legitimate argument can be made with respect to some kinds of R&D, I believe. It is possible a national security argument can be made with respect to the energy sector, for example. And to the extent that the ordinary workings of the marketplace in a neutral system would result in what is an underinvestment from the standpoint of overall judgment of public good, then I think you would have to modify the system.

Senator BOREN. In regard to the balance of trade and the strong dollar, you stressed other elements in your answer, other than the domestic budget deficits. How important do you think the domestic budget deficits are in determining the exchange rate and having impact on the strength of the dollar, and do you think that there is any way short of weakening performance in our own economy to

try to bring down the value of the dollar in the long range without tackling the problem of domestic budget deficits?

Mr. DARMAN. I have already suggested, Senator Boren, what is my basic view on this, and that is that we ought to focus principally on trying to improve the growth and investment prospects of other countries as a way of dealing with the dollar problem. I think the relationship of the deficit to the dollar problem is arguable. But having said that, I think that the point I just made is somewhat irrelevant. There are sufficient reasons to be concerned about U.S. deficits to justify what is being proposed to deal with them independently of consideration of international economic effects. And from that standpoint, I am fully satisfied that everything we will be proposing to reduce the deficit, which I recognize is rather considerable, and will present some considerable political difficulty, that everything we are recommending is well worth recommending for a variety of reasons. And the reasons range from the desirability of reducing our own long-term debt burden, which is both an economic matter and in my opinion also a moral matter—I am referring to the fact that future generations aren't fully represented in current decisionmaking—to considerations having merely to do with the efficiency or proper role of Government. So, there are full and sufficient reasons to be concerned about deficit reduction without stretching to this, I think, somewhat arguable issue.

The CHAIRMAN. Senator Wallop?

Senator WALLOP. Mr. Chairman, just quickly, only one observation, and then a short question. The observation is from what Senator Bradley said and so many of us always use, that special interests are gathering, and I am reminded of the little guy in Bloom County who has the closet full of anxieties that come out and visit him in the night and recently canceled his childhood——

[Laughter.]

Senator WALLOP. I think that is a comfortable excuse for saying it is a difficult chore, and I think all of us recognize that. And special interests, after all—I know of no greater special interest that walks the Halls of Congress than reelection. [Laughter.]

So, putting that where it is, let me just ask one quick followup to the line of questioning that I was engaged with you on when my time ran out. And that is, we are talking about trying to strengthen the economies of Third World countries, and it would be my hope, and I would ask for you to comment on it, that the administration would spend more of its time trying to strengthen the economies of free Third World countries than they would those behind the Iron Curtain.

Mr. DARMAN. I think that has unquestionably been the pattern, Senator Wallop, and it seems to me it would continue.

Senator WALLOP. Now, when I listened to some of the plans that we have in mind for Poland and other places, I sometimes question whether indeed we reflect what we do in rhetoric. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Mr. Darman, you are a serious person. I just wanted to clarify an earlier exchange we had, that might look awkward in the record. I asked you about your statement concerning the constitutional right to bear arms, and you asked at one

point: What relevance do the constitutional views of Deputy Secretary of the Treasury have in this regard? I would point out to you that, first, you take an oath to uphold and defend the Constitution, and so you have an obligation to understand it. Second, you are responsible for gun control at the Treasury Department. The Bureau of Alcohol, Tobacco, and Firearms, as I understand it, took 16 minutes to trace the gun used to shoot President Reagan in 1981. My point is that firearms are the responsibility of your Department, and your understanding of what the Constitution—the protection it provides to the State and to the people as individuals—is important. So, will you respond to me on this? I ask that you write me a note on the subject.

Mr. DARMAN. Yes, I will, Senator.

Senator MOYNIHAN. Let me then go to two other things. The first is something I mentioned last week to Mr. Baker. The Treasury Department has jurisdiction over Customs, which includes drug interdiction. In the recent past, the Under Secretary has had primary responsibility for Customs. Have you discussed with Mr. Baker how you are going to divide responsibilities? Everybody can't do everything.

Mr. DARMAN. We have not divided up responsibilities among us, as of this point, Senator. In fact, it would be a little presumptuous, I think. We have talked only in a preliminary sort of way. With respect to drugs, I think the pattern has varied as to whose responsibility it has been, but in the most recent past, I am led to understand that Deputy Secretary McNamar has played the principle role, much more so than Secretary Regan with respect to that issue.

Senator MOYNIHAN. Without intending any criticism, would you agree that we are not succeeding in our effort to control the movement of drugs into this country?

Mr. DARMAN. It is always a reasonable question to ask, by what measure, but by any number of reasonable measures that I would apply, it seems to me evident we are not succeeding. And I similarly don't mean any criticism of the prior incumbents. But obviously with a drug problem of the size that is evident in this country, it would be somewhat difficult to claim success. We have previously discussed that, and I think we agree on the importance of this issue area generally for the health of this society, and we recognize also the role that Treasury has to play.

Senator MOYNIHAN. One last question. The Treasury plan includes a proposal to abolish section 936 of the Internal Revenue Code. Section 936, the so-called possession tax credit, gives a tax credit for U.S. corporate taxes attributable to income earned in the possessions, including Puerto Rico. The credit is designed to encourage investment in the possessions. It has been a part of U.S. tax policy since 1921. Section 936 has acquired a kind of quasi-constitutional role in the life of the Commonwealth of Puerto Rico. I am not asking you to take a position regarding economic or tax policy here, but as we proceed to consider section 936, can I hope that you in Treasury will understand we are dealing with something more here than rationalization of the Tax Code or revenue enhancement? We are dealing with our relations with the citizens of this country who are not represented in this Congress.

Mr. DARMAN. Yes, sir.

Senator MOYNIHAN. I will appreciate that, and I know they will, too. Thank you, Mr. Darman.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Thank you very much, Mr. Chairman. In the previous line of questioning, we discussed the sequence of when things would occur. From my standpoint, both things could easily occur this year in whichever sequence. Maybe if could even happen by August. What I was concerned about, however, was the rationale that emerged today for putting spending first and tax simplification second. And the comment was we will need the people that will oppose tax simplification for deficit reduction. Could you expound on that a little bit? What do you mean?

Mr. DARMAN. I didn't say that.

The CHAIRMAN. That wasn't his comment.

Senator BRADLEY. Oh, that was not your comment?

Mr. DARMAN. No, sir.

Senator BRADLEY. Whose comment was that?

The CHAIRMAN. That was one of the Senators at the meeting, but I don't know if Mr. Darman was there when the comment was made.

Senator BRADLEY. Oh, OK. Then, I won't attribute that to you.

Mr. DARMAN. I believe it was Senator Armstrong's comment, and I would suggest that you might discuss it with him.

Senator BRADLEY. Oh. I think it should be fairly clear why that could be someone's view of someone because, as I take that comment, it means that you will need those who have benefitted from the fastest growing Government program—tax expenditures that have gone from $37 billion in 1967 to $370 billion in 1984—you will need those who benefit from that Government program in order to cut education, environment, child nutrition and so on. And I would hope that the administration would not offer that rationale for tax simplification, nor for the sequence of tax simplification.

Mr. DARMAN. To the best of my knowledge, Senator Bradley, we have not done so. I think that the sequence at the moment is inescapable. The budget is ahead of the tax process, and this tax undertaking is large enough so that, even if we work on it as quickly and as well as we can, the budget is going to stay a little bit ahead of it, certainly for the next couple of months.

Senator BRADLEY. One last question, Mr. Darman, and that relates to another subject. What would you have said in 1980, as you were contemplating this job—the job you just left—if someone had told you that the administration that you were going to serve would be the first administration perhaps in history, or at least in memory, that decided as a matter of policy to nationalize a bank, as the Continental Illinois bailout produced? Would that have surprised you?

Mr. DARMAN. I wouldn't have expected profound shock to have been my reaction to the possibility. It doesn't strike me as an extraordinarily implausible possibility.

Senator BRADLEY. Well, that is a very interesting comment.

Mr. DARMAN. I wouldn't want you to attach too much importance to it.

Senator BRADLEY. Yes, but you don't want the headline tomorrow to say: Reagan administration appointee in favor of nationalizing banks.

Mr. DARMAN. I don't think that would be a fair construction of what I said at all. First of all, it was your characterization, and second of all, you are really asking: Could you have conceived of a low probability event? And would you be shocked by the possibility of a low probability event? There are all kinds of low probability possibilities that one imagines are possible. My reaction is more a function of personality on this issue and the way I think about things than it is the substance of the matter.

Senator BRADLEY. I think that is the appropriate comment for someone who will be one of the major players in the tax reform battle.

Mr. DARMAN. I am not sure how to take that.

The CHAIRMAN. Any other questions? If not, Mr. Darman, thank you very, very much.

Mr. DARMAN. Thank you very much, Mr. Chairman and members of the committee.

The CHAIRMAN. I see his immediate predecessor, Mr. Chapoton, in the audience. Are you here, Buck, for any purpose other than amusement? [Laughter.]

Senator Danforth.

Senator DANFORTH. Well, Mr. Chairman, in answer to your question, I assumed that Buck Chapoton's presence meant that he was going to be nominated as Deputy Assistant Secretary. [Laughter.]

Mr. Chairman, I have been privileged to be invited by the nominee to present him to this committee. And, obviously, that takes no effort at all because there is no one who works more closely with the Finance Committee, no one from the administration who works more closely with the Finance Committee, than does the Assistant Secretary for Tax Policy. Every time there is a tax bill, the Assistant Secretary is sitting right at this table.

And Ron Pearlman has been at this table many times in the past. He has been in the administration since a year ago last summer. For about 1 year, he served as Buck Chapoton's Deputy, the Deputy Assistant Secretary for Tax Policy. And since last summer, he has served as the Acting Assistant Secretary for Tax Policy.

I think that those of us who have seen Ron Pearlman at work have become acquainted with an extraordinarily able person, a person who not only has an encyclopedic knowledge of the tax law, which he does, but who is gifted with the ability to explain its meaning in a very clear fashion, and to address himself to the concerns of members of this committee in a very helpful way.

I think that it's fair to say that Ron Pearlman is capable of explaining the administration's intractable opposition to the proposals of members of this committee with the same polish and the same sympathy as characterized his predecessor.

Ron has a very distinguished career in the law. He came to Washington having been a member of a very good law firm in St. Louis, the Thompson & Mitchell law firm, a firm with which I did some business when I was practicing law in St. Louis.

He has also taught law on an occasional basis. He has written reasonably extensively, and his publications are noted in the back of his resume. And in addition to all of that, he has found time to serve his community of St. Louis in a variety of civic projects.

So it is my honor, Mr. Chairman, to present to the committee a person who has been before the committee many times—the President's nominee for Assistant Secretary for Tax Policy, Ron Pearlman.

The CHAIRMAN. Senator Danforth, thank you.

Mr. Pearlman.

STATEMENT OF RONALD A. PEARLMAN TO BE ASSISTANT SECRETARY OF THE TREASURY

Mr. PEARLMAN. Good morning, Mr. Chairman and members of the committee. Let me begin by simply thanking Senator Danforth for his very kind words. I am a proud Missourian and made even prouder by Senator Danforth's presence on this committee and his representation of our State in the Congress.

I do not have a prepared statement, Mr. Chairman. I would simply like to express my appreciation for having the opportunity to appear this morning. Over the last year and a half, I have had the pleasure, and, indeed, the honor to work closely with the members of this committee. It has been both a professional and personal highlight of my career. I think that relationship has been a good one. I hope it has.

[A biographical sketch of Ronald A. Pearlman and a letter from the U.S. Office of Government Ethics follow:]

RONALD A. PEARLMAN

A. BIOGRAPHICAL:

1. Name:

Ronald Alan Pearlman

2. Address:

4921 Crescent Street
Bethesda, Maryland 20815

3. Date and Place of Birth:

July 10, 1940, Hamilton, Ohio

4. Marital Status:

Married
Hedy Sue (Wolff) Pearlman

5. Names and Ages of Children:

Steven W. Pearlman - 18 years
Leslie C. Pearlman - 16 years

6. Education:

Wilson Junior High	1952 - 1955	
Hamilton High School	1955 - 1958	
Northwestern University	1958 - 1961	B.A. w/honors
University of Cincinnati	Summer, 1960	
Northwestern University School of Law	1962 - 1965	J.D.(cum laude)
Georgetown University Law Center	1965 - 1967	LL.M. (Taxation)

7. Employment Record:

May 1965 - May 1969
Attorney-Adviser
Interpretative Division
Office of the Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D. C. 20224

May 1969 - July 1983
Thompson and Mitchell
One Mercantile Center
St. Louis, Missouri 63101
Associate - 1969 - 1970
Partner - 1971 - July, 1983
Partner in charge of tax department - 1976 (approx.) - July, 1983

1970 - 1971
Part-time Instructor
Meramec Community College - St. Louis County Junior College District
7508 Forsyth Boulevard
St. Louis, Missouri 63105

February 1972 - July 1983
Adjunct Professor of Law
Graduate Tax Program
Washington University School of Law
Campus Box 1120
St. Louis, Missouri 63130

8. Government Experience:

August 1, 1984 to present
Acting Assistant Secretary (Tax Policy)
Office of the Secretary
Department of the Treasury
Washington, D. C. 20220

July 1983 - July 1984
Deputy Assistant Secretary (Tax Policy)
Office of the Secretary
Department of the Treasury
Washington, D. C. 20220

Government Experience: - Continued

May 1965 - May 1969
Attorney-Adviser
Interpretative Division
Office of the Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D. C. 20224

1969 - 1973, Chairman, 1978-1979
Advisory Committee
Director of Revenue
State of Missouri

9. Memberships:

Missouri Bar

Illinois Bar

Bars of the U.S. Supreme Court, Tax Court and Claims Court

The American Law Institute

American Bar Association, Section of Taxation, Legislative Recommendations Committee and Committee on Partnerships (Chairman, Subcommittee on Contributions and Distributions, 1982-1984; Chairman, Subcommittee on Incorporations, Corporate Stockholder Relationships Committee, 1974-1976)

Fellow, American College of Tax Counsel
Missouri Bar Taxation Committee (Chairman, 1976-1978)
Taxation Committee, Bar Association of Metropolitan St. Louis (Chairman, 1974-1975)
Chairman, 1979 Mid-America Tax Conference
Southern Methodist University Tax Symposium Advisory Committee
Regional Vice President, Northwestern University School of Law Alumni Association

Danforth Foundation
St. Louis Leadership Program - 1980 - 1981

St. Louis Metro Forum

United Way of Greater St. Louis
Chairman, Children's Services Budget Panel and
Member of the Agency Operations and
Planning Cabinet, 1979 - 1982

St. Louis Jewish Center for Aged
Board of Directors (President, 1983)

Jewish Federation of St. Louis
Board of Directors
Member of Endowment Fund and Community Services
Planning Committees
Secretary 1982, Member of the Executive Committee,
1982, Budget Committee Vice Chairman 1982

Missouri Athletic Club, St. Louis, Missouri

Westwood Country Club, St. Louis, Missouri

10. Political Affiliations and Activities:

I have made political contributions to Republican candidates and political parties at both the local (St. Louis and St. Louis County, Missouri) and national levels dating back to 1976 with amounts ranging from $25.00 to $100 per contribution. In addition, I have made contributions to Congressman Gephardt's election committee. (Mr. Gephardt and I were classmates in college and practiced law in the same St. Louis law firm for the eight-year period prior to his being elected to the Congress.)

11. Honors and Awards:

Order of the Coif
Board of Editors, Northwestern University Law Review
David N. Grosberg Leadership Award of the Jewish
Federation of St. Louis (1982)

12. Published Writings:

Co-Author, Buying, Selling and Merging Businesses (ALI-ABA, 1975; Supplement 1978)
Author, BNA Tax Management Portfolio, Corporations--Assumption of Liabilities (1976)
Co-Author, Closely Held Corporations (Illinois Institute for Continuing Legal Education, 1977)
Editor, Missouri Taxation Law and Practice (Missouri Bar, 1981)
Author, The Taxation of Installment Sales, 6 ALI-ABA Course Materials Journal 55 (April, 1982)
Editorial Advisory Board, Federal Tax Annual: Real Estate, (Warren, Gorham & Lamont, Inc.)
Author, Tax Considerations Upon the Withdrawal of a Partner, Proceedings of Southern Methodist University Symposia on Federal Taxation (RIA 1979)
Author, Recasting the Multiple Corporate Group, Journal of Taxation, (October, 1974)

United States of America
Office of Government Ethics

Office of Personnel Management
Washington, D.C. 20415

JAN 28 1985

Honorable Robert Packwood
Chairman, Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with the Ethics in Government Act of 1978, I enclose a copy of the financial disclosure report filed by Ronald A. Pearlman, who has been nominated by President Reagan for the position of Assistant Secretary of the Treasury (Tax Policy).

We have reviewed the report and have also obtained advice from the Department of the Treasury concerning any possible conflict in light of the Department's functions and the nominee's proposed duties. Based thereon, we believe that Mr. Pearlman is in compliance with applicable laws and regulations governing conflicts of interest.

Sincerely,

David H. Martin
Director

Enclosure

Mr. PEARLMAN. I look forward to a continued good relationship with the committee. And the opportunity to work with you, Mr. Chairman, and members of the committee.

Thank you.

The CHAIRMAN. Mr. Pearlman, a quick question. You are reasonably familiar with the Treasury proposal on tax reform, I assume.

Mr. PEARLMAN. I have heard about it, yes, Mr. Chairman. [Laughter.]

The CHAIRMAN. One of the proposals is to increase the IRA's to $2,500, and an additional $2,500 for a nonworking spouse. Is that a good proposal in your mind?

Mr. PEARLMAN. Yes, I think it is a good proposal. I think we have emphasized in this proposal the utility of the IRA as part of the package of tax incentives designed to aid people in planning for retirement, for their later years. One of the major policy issues we decided early in trying to develop a fundamentally reformed income tax system was to keep the incentives in the tax system for retirement planning. So we made a major decision, for example, to leave the tax incentives essentially as they are for qualified pension and profit sharing plans.

We recognized, as the Congress did when the IRA was originally enacted, that qualified pension and profit sharing plans aren't available to everyone. And they, in a sense, discriminate against people—certain self-employed individuals, nonworking individuals, spouses who work in the home—people who don't have the benefit of qualified plans.

And so we viewed the IRA as a very important piece of that retirement planning.

The CHAIRMAN. Although the IRA deductions significantly reduce the income tax base?

Mr. PEARLMAN. Yes. We recognized that. And, again, in one of the policy decisions we made, we said that we thought that there was an important role to be played by the tax system in continuing to encourage financial independence by individuals in their retirement years.

The CHAIRMAN. So basically it's a legitimate use of the Tax Code to achieve what is regarded as a worthy social purpose?

Mr. PEARLMAN. Clearly that and certain other decisions we made were, in our judgment, legitimate uses of the Tax Code. Yes.

The CHAIRMAN. What are the most recent statistics you have on the income distribution of those who purchase IRA's?

Mr. PEARLMAN. I don't have that data at my fingertips, but I can give you a couple of pieces of information.

The CHAIRMAN. Go ahead.

Mr. PEARLMAN. The average contributions that are being made to IRA's now are currently running at about a little over $2,000, which is very interesting. It's much higher than we thought.

The CHAIRMAN. I don't mean how much, but the income level of those who are buying them.

Mr. PEARLMAN. And that the IRA's are being used across the income classes. That incomes below $50,000 are making substantial use of the IRA.

The CHAIRMAN. How about incomes below $15,000?

Mr. PEARLMAN. Well, with respect to incomes below $15,000, I would think not, Mr. Chairman. But I would be happy to provide that distribution data. I simply don't have it in front of me.

The CHAIRMAN. Now let me ask you a second question. In the Treasury report, you want to, if not get rid of, at least significantly discourage the 401-K pension plans.

Mr. PEARLMAN. Yes. I would like to put it slightly differently. I think what we would like to do is to see the 401-K concept be effected not through the present 401-K, because it's not available to everyone and it's available in a discriminatory way, but effected instead through the use of the IRA, which is available for everyone. And, therefore, we would make that vehicle for encouraging savings for retirement available to everyone in the country.

The CHAIRMAN. Do you know what the income distribution is of those who currently have available to them 401-K pension plans?

Mr. PEARLMAN. Again, I don't have that data in front of me, but I think the data would indicate that the 401-K plan, because of the much higher dollar amounts that are possible to be deferred under 401-K, tends to be skewed to the higher income levels. But, again, we would be happy to provide that to you.

The CHAIRMAN. I think you will find in terms of the breadth of the availability that it's skewed toward more middle income and lower income groups than higher. You have a higher limit. But if you mean are more people taking advantage of 401-K or IRA's in a middle income tax level, I will bet you will find that the 401-K's have a greater participation.

Mr. PEARLMAN. That could be. Again, I will be happy to provide that data to you.

The CHAIRMAN. Next question. You know, I'm no great fan of industrial development bonds, but the argument has been raised—if we don't have it, as far as rental housing for lower income, it's going to go up 40 to 60 percent. This argument has been made to you before. What about that?

Mr. PEARLMAN. Well, frankly, we have not heard the argument that the cost of rental housing will go up by that percentage as a result of the change in the industrial revenue bonds. We've heard the argument that a combination of provisions in the Treasury proposal—my guess is the most significant of which is not the industrial bond proposal but rather the interest limitation will drive up the cost of rental housing. That is one of the pieces of data that we have asked the housing industry to provide and develop for us. We have received some of that data and we are working with the industry. And one of the questions we asked them was: What were the pieces of the proposal that might result in rather high increase in rental costs? And we are looking forward to receiving that data.

My guess would be that it would not be the industrial development bond provision.

The CHAIRMAN. But the 40 to 60 percent is not out of range of the entire package then?

Mr. PEARLMAN. I think that is the estimate that has been submitted to us; that the package could have an effect on certain rental housing, as much as a 40 to 60 percent increase.

The CHAIRMAN. Basically, lower income rental housing.

Mr. PEARLMAN. Yes. I think the information we received was that the average rental in the United States is now currently about $300 per month, and the expectation is that it could go up somewhere around 25 percent.

The CHAIRMAN. I will come back to that.

Senator Roth.

Senator ROTH. I, too, want to welcome you here, Mr. Pearlman. I think we are very fortunate to have you available for the assignment you are undertaking.

Before I get into some questions on savings, I would like to address a problem, this problem of vehicles and farmers. I understand and have read rather rapidly the new press release on this matter.

Mr. Pearlman, this is an example, in my judgment, where a good idea goes wrong. It's an idea which, I think, helps build unfairness into the picture.

And let me tell you why I say that. It seems to me that this legislation, which was an initiative, I think on the Senate floor, was to avoid—those people who were using expensive cars for personal use and paying no taxes accordingly; that it was a tax loophole.

But my concern is what is happening because of the regulations—and I understand you are put under some very heavy requirements. What is happening is this: First of all, those who have used it as a tax loophole are going to be protected. They are going to be able to, without maintaining any records whatsoever, shelter 70 percent of those costs.

On the other hand, the farmer, the little guy whose teenagers may use that truck to go to a dance or something, is going to have to keep detailed records, detailed records, if he feels he's entitled to more of a deduction than 70 or 80 percent, as the case may be.

Now it is that kind of situation, it is that kind of regulation, that I think builds in unfairness into the picture. And, again, I understand the problem that the Treasury had because this was an initiative of the Congress. I think it makes no sense what we did, at least the way we did it.

But I'm bothered. And I wonder if you would agree with me that basically under these regulations you can pretty much protect 70 percent of the cost without any records?

Mr. PEARLMAN. Senator, permit me to make a few comments. First, I think it is very important for the members to understand that the problem of recordkeeping with respect to cars is not one that grew out of the 1984 act. I mean the issue of keeping records for cars has been in existence for years, and the only thing the 1984 act did was to make it crystal clear that those records must be contemporaneous records rather than records created on April 14 of each year.

Senator ROTH. Let me interrupt because I understand that.

Mr. PEARLMAN. All right.

Senator ROTH. But it's not so much sometimes what the facts are but the perception. Then here comes an administration that came in that was going to lighten the paperwork burden of government, and what we are going to do now is to impose a heavy burden on the individual farmer just to prove that he isn't using it except de minimis. I wonder how are you going to be able to enforce these regulations. I understand Treasury would like more revenue

agents. Are we going to put them out on the farms watching what the farmers are doing?

Mr. PEARLMAN. Let me go on and say that I think one of the difficult problems we had in designing those regulations was trying to balance the problem of people using property which is being depreciated and for which tax benefits are being received for personal use against the burden that is imposed on people that are using property absolutely legitimately in their business.

I think that the regulations that we have come out with over the last several months went too far in trying to impose recordkeeping demands. And, hopefully, we will find out more over the next month or so as our revisions receive some comment.

I think that we have identified categories of taxpayers today so that the people who use their cars purely for pleasure and are gaining advantage of the tax system, will not be able to use the 70 percent rule or the 80 percent rule. And, hopefully, the farmer who is using his vehicle fully for business or just very incidentally for pleasure will not be put under an undue burden.

Let me say we assume that if the farmer wants to depreciate more than 80 percent of a truck or more than 70 percent of a car, he must keep a record of his personal use. Our judgment is that if the farmer does that and at the end of the year determines that he had no personal use and so retains some record of that, Revenue agents are not going to come in and try to second-guess those determinations.

We know that there will be people that won't be quite honest with the system. But we also know that is the way to take the burden off of the farmer, which is one of the things we intended to do.

Hopefully, the rules, as we announced them last Friday, will dramatically ease the burden; not just on farmers but on small businessmen, on salesmen, and on servicemen. And we hope over the next several weeks, if that's not the case, that we will hear from people.

Senator ROTH. Well, my time is up. I'm just concerned that what the thrust of these regulations are, that those that are abusing the privilege will be able to shelter 70 or 80 percent without keeping any records. It's going to be impossible to disprove. And enforcement is going to be extraordinarly difficult.

On the other hand, the little business guy or the farmer who may once in a while use a truck or something is going to be burdened with paperwork and they are going to laugh at us.

The CHAIRMAN. Senator Danforth.

Senator DANFORTH. Mr. Pearlman, I am going to make a forecast of what Congress is going to do on the tax reform package. I believe that we will pass a tax bill this year, late this year. I believe that we will, contrary to the advice of Senator Long and Senator Packwood, call it something like the tax reform bill of 1985. I believe that when we are all finished with the bill, columnists will write it up asking the question: How can this be a tax reform bill or a tax simplification bill when it adds 500 to 1,000 pages to the Internal Revenue Code?

My, maybe too cynical, view is that tax simplification is all but impossible to come by; that quite the contrary of the bum's rush

approach, which was described by Senator Long, we in the tax writing committees operate at such a leisurely pace with so many people—lobbyists and so on—looking over our shoulders that any tax bill necessarily develops all kinds of appendages and that this bill will be no exception to that.

It used to be that, I think, Congress passed a new tax bill about once every 7 years. That at least gave the rest of the country an opportunity to figure out what was going on and to plan accordingly.

Now, we have passed three major bills during the first Reagan administration, and some minor bills as well. And my concern is that we are not only not moving toward simplification, but that tax law becomes more and more unpredictable as we keep tinkering with it and changing it. And that there is a very strong possibility that what we will end up with after several months of agonizing deliberation is something that is more complex and more tinkering added to the code.

I hope that the policy of the administration—and you will be the Assistant Secretary for Tax Policy—I hope that the policy of the administration is to insist on something that is relatively simple, and straightforward, or be prepared to just scuttle the whole process somewhere down the road.

But I would like for you to comment on that. Can you foresee circumstances in which what we do ends up—maybe it is good—but ends up just so complicated and contrary to the idea of simplification that we finally decide, look, maybe this is a reasonably good tax bill, but we just can't afford every year to tinker with the Internal Revenue Code.

Mr. PEARLMAN. Well, let me try to respond to your question with several comments, Senator Danforth.

First, I think everyone involved with the tax system shares your concern with the frequency of legislation. It is a very serious problem. It's not just a serious problem for taxpayers; it's a serious problem for Government. We have to worry about people understanding the tax system, advisors being able to properly advise taxpayers, and we have to worry about the Internal Revenue Service being able to administer the system. All of those are important in maintaining the integrity of the system. So I think that concern of frequency of legislation is a major concern.

I would add, however, my own judgment that it's not a matter of fundamental tax reform versus no legislation. My prediction—and one of the reasons that I think it is so important to reexamine the tax system on a fundamental basis—is that over a period of years as the system gets more complex, we are going to see more aggressive transactions designed to get around the current rules and you will find the Treasury Department and Members of Congress being concerned about these transactions bringing them to the attention of the committee. We will end up with a repetition—maybe not every year, maybe it will be every 2 or 3 years—of 1984 Acts over and over again. I think that, too, is a serious problem.

I think we have to be careful. And I think Senator Packwood said it very well in his discussion with Mr. Darman. We have to be careful when we talk about tax simplification.

I am seriously committed to achieving some real simplification for individual taxpayers in this country. I mean simplification in its naked form. For example, I believe that a proposal that increases the number of nonitemizers by 7 percentage points—that's another 5 million or so people—is an improvement in terms of the complexity of the system, which, I think, is important to individual taxpayers. Also, I don't think we should lose sight of our ability to simplify the business tax system. For example—although I know it's an issue which is and will continue to be a very controversial one, the proposal to eliminate the preferential rate on capital gains has major simplification benefits.

I also think it is equally important in a fundamental reexamination of the system to look at the fairness of the system, even if that fairness in certain circumstances contributes not to the simplification of the system but adds some complexity to the system.

For example, I think we can bring some fairness among the way businesses are taxed. I can assure you that those businesses that are paying a much higher tax rate than other businesses today will be happy to have a little additional complexity in order to achieve a fairness in the manner of taxation. I mention that specifically because of the indexing proposals in our package.

I hope that we can produce, if it is the Congress' will, a fundamental reform of the system that achieves the maximum degree of simplification and fairness and that we can do it in a way that permits us several years from now to look back and say that it was not just another in a line of pieces of tax legislation that did not contribute to the integrity of the system. I hope that's possible.

Senator DANFORTH. Thank you.

The CHAIRMAN. Senator Long.

Senator LONG. Mr. Pearlman, let me first say that I'm going to support your confirmation. I think you are qualified for the job. Have you been confirmed with the job you now hold? I know that if you were, I voted for you. Can you recall? [Laughter.]

Mr. PEARLMAN. I was not, but thank you.

Senator LONG. You have or have not?

Mr. PEARLMAN. I have not been confirmed before.

Senator LONG. Well, that's news.

Mr. PEARLMAN. But I appreciate your vote.

Senator LONG. You will be confirmed.

Mr. PEARLMAN. Thank you.

Senator LONG. As far as I know, every Democrat over here is going to vote for you and I'm going to vote for you.

Mr. PEARLMAN. Thank you very much.

Senator LONG. I think you are qualified for the job, and I will be pleased to support your confirmation.

I think that it is sometimes unfair for us to debate policy issues with nominees for a position when they come before us, as you do, because you are there with a sword of Damocles hanging over your head. If you don't watch out, you will say something that some Senator doesn't like, and then he will go out and oppose your confirmation; he might even filibuster against it. It's a very vulnerable position a man is in when he comes before the committee as you do.

So I don't want to debate the issue with you. I just think that we might have something of an exchange. Let me say that I'm all for simplification. Personally, I would think that we ought to be able to increase the number of nonitemizers a great deal more than your proposal would.

Perception sometimes gets to be more of a problem than fairness. I particularly have in mind one item that you are not recommending changing. I have discussed this with Mr. Darman.

Many people have the idea that rich people pay no taxes. I'm sure there are some who pay no income taxes, but most of them do. We will never completely eliminate this perception of rich people paying no taxes as long as we leave them something that has been there since the beginning of time; that is, the tax exemption for the full faith and credit obligation to State and local governments.

You are not recommending changing that. And I have argued from time to time that the *Pollock* case is still good law and that it would be unconstitutional to tax such interest. I don't think you share that view, do you?

Mr. PEARLMAN. No, I don't share that view. We have not changed—our proposal does not change current law with respect to so-called governmental obligations, obligations issued for governmental purposes. They would remain tax exempt.

Senator LONG. That's right. As long as that is the case, we will continue to hear that someone, such as Mrs. Dodge did some years ago, invests their money solely in Government indentures and pays no income tax. I think you heard me say to Mr. Darman that Bill Simon as Secretary of Treasury used to contend that such interest has already been taxed because you get about 30 percent less yield on that type of obligation than you do on a taxable obligation.

As long as we leave that provision the way it is—and the way you are recommending it right now—how are we going to get rid of the perception of rich people getting by things in the income tax?

Mr. PEARLMAN. Well, Senator, I agree with you that to the extent that we leave tax exemption and do nothing else that there will be some taxpayers who, in fact, will pay no Federal income tax.

Let me say that there is a way to deal with that, and that is through a minimum tax. We have indicated in our report that while we were in favor of eliminating minimum taxes because, again, we thought that contributed to the simplification of the system, we were concerned about the perception of either individuals or corporations not paying any tax. That is an issue that we believe is appropriate of further discussion. I wouldn't today want to suggest that any mimimum tax should apply to interest on State and local obligations. We have made a judgment that is not appropriate; we want to give State and local governments continued ability to finance their governmental operations and get the full benefit of tax exemption. And certainly a minimum tax would encroach on that. But certainly that is an option available to the Congress.

Senator LONG. There is one other problem along the same line. I was told that, according to the studies made by Treasury, one of the largest categories of persons paying little or no income tax was persons who find themselves in that situation because of the foreign tax credit. There, again, we run into a similar problem. If one

is doing business in a foreign country where he is paying, let's say, a 70 percent or even an 80 percent tax on net income, he is entitled to claim the foreign tax credit on his U.S. income tax. To say that such a tax can be very misleading, because he actually paid a lot of taxes, but he simply paid them to a different government.

The rule tends to be that, among equal sovereigns, you get a credit, not a deduction, for what you have paid in taxes to an equal sovereign. Are we going to have to change the rules to allow only a deduction, when it has been an established rule that you are entitled to a credit for what you have paid the other sovereign?

Mr. PEARLMAN. Senator, I think both of those examples point out one of the unfortunate things that happens when you just look at statistics and you see *x* number of people don't pay tax in a particular year. I think we would share your view that someone eligible for a foreign tax credit under well-established international principles, simply because he doesn't pay the tax in the United States, is not viewed as a tax evader. He has, in fact, paid a tax.

When we do more specific analysis of who pays tax and who does not and why, we do not view people who have availed themselves of the foreign tax credit as being the kind of taxpayer that we are concerned about in terms of not paying tax in the system. I think it is simply a matter of analyzing that data to make sure we understand the different categories of taxpayers.

Senator LONG. I'm just wondering if we are going to be compelled at some point to vote to put a big tax on someone who has already paid his fair share, just to respond to an erroneous perception. That's troublemaking.

Mr. PEARLMAN. We have not suggested that, and I would hope that we would not do that.

The CHAIRMAN. Senator Boren.

Senator BOREN. Thank you, Mr. Chairman.

I want to associate myself, Mr. Pearlman, with the others on the committee that have spoken about their pleasure at your appointment. And I enthusiastically support your confirmation. I think we are very fortunate, as in the case of Mr. Chapoton, to have a person of your ability, your understanding of the Tax Code and your professional expertise willing to serve in this position. And I'm grateful that you do have that willingness.

I think we all recognize that fairness and the perception of fairness is very important to the Tax Code, and we are struggling with that in this whole proposal for simplification and change this year.

There is no way to have enough agents to enforce the Tax Code that is so widely perceived as unfair that you do not have a high level of voluntary compliance. I wonder if the Treasury has any kind of an indicator that it uses or any method that it uses to track the level of voluntary compliance with the Tax Code.

Mr. PEARLMAN. Yes. First, let me thank you for your comments, Senator.

The Service does undertake analyses—the most recent analysis is with respect to 1981 data, and has received heavy publicity over the last year or so—in which it seeks to measure the so-called tax gap, which is an effort at trying to evaluate what taxable income, if you will, that escapes taxation. And that analysis is a continuing one. The Service has been doing it for a number of years. The esti-

mate now is around $80 billion, made up of both the illegal and the legal sectors. That analysis, indeed, breaks those items into specifics—how much in terms of dollars of overstated deductions; how much in terms of understated income; how much from drug traffic; and other things. So the Service seeks to do that.

Senator BOREN. How much has that grown over the last decade as a percentage factor?

Mr. PEARLMAN. I can't answer that. Obviously, the absolute number has grown. I would guess—and I'm only guessing—that there probably has been some growth in the percentage of noncompliance but I simply can't answer that question.

Senator BOREN. That's something that I hope you will keep the committee informed on periodically because I think that while we are concerned about uncertainty created—and I agree with what Senator Danforth said, and I think you also know my concern for encouraging savings and capital formation—that we also have to keep our eye on the problem of voluntary compliance and making sure that the system is perceived as fair.

Let me express my appreciation to you also—the members of your staff have already met with us in an effort to resolve this problem that has been ongoing of getting a definition of new oil under regulation since we changed the law some time ago to apply certain rates.

Are you hopeful that we will be able to work that out in the near future and get a regulation actually issued in that area?

Mr. PEARLMAN. Yes, Senator. I think we are almost there. I think we have worked it out, and now it's mechanical; that is, just getting the regulation drafted and issued. And we hope that that regulation will deal satisfactorily with the issue.

Senator BOREN. Thank you. Also going back to what Senator Roth said a minute ago in regard to the logging, I think that the statement—I did read over in some detail the proposals that the Treasury released Friday or Saturday in the press release of changes. They are certainly a step in the right direction. That it does appear—definitions of agriculture, for example—other occupational groups that don't fall into the salesmen-service category. We may still need to find a way of providing some option to the taxpayer of taking a certain percentage. So there still seems to be some other areas that need further work. And I would just encourage that the Treasury call another meeting. I know there has been one meeting already with allies from the Finance Committee members. That another meeting perhaps be called seeking to refine these proposals a little further before they are finally issued formally.

I think they maybe come two-thirds of the way, but I think there is still some remaining problems to be worked out. And I would hope that perhaps another meeting could be held soon with staff members of interested members of the Finance Committee to try to work that out.

Mr. PEARLMAN. Let me say that we would be happy to do that, Senator Boren. And I want to take the opportunity to reemphasize—and I perhaps did not do it strongly enough when Senator Roth asked a question—that we have tried with those regulations—and I might add others—after the 1984 act to get regulations out as

quickly as we possibly could because we thought that was in the interest of taxpayers to have guidelines out there. Where members of the public and Members of the Congress have disagreed with us, we have tried as best we could to react on a reasonable basis to those concerns, and I would hope that dialog would continue.

Senator BOREN. I appreciate that. But I would urge maybe another meeting in the very, very near future so that we can finally get it resolved.

Mr. PEARLMAN. We would be happy to do that.

Senator BOREN. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. I would like to join this chorus of greeting to our friend, Mr. Pearlman.

I want to note the exchange between the chairman and Mr. Pearlman in which the chairman asked whether the individual retirement account or IRA was a legitimate use of the Tax Code for advancing an objective in social policy. Secretary-designate Pearlman stated that he considered it legitimate. So it is conceded that it is legitimate to use the Tax Code to advance a social policy, and the only remaining question is what social policy objectives should be advanced. Actually, there is no such thing as a socially neutral tax code; it is an oxymoron. The Tax Code is a social policy right then and there. The Government will exact forced labor from you.

Just two things, sir. Just out of curiosity, your $80 billion figure is a net loss of taxes. Right?

Mr. PEARLMAN. It's a net revenue loss.

Senator MOYNIHAN. Net revenue loss as against income not reported.

Mr. PEARLMAN. Well, it includes that. I thought you meant the tax liability on unreported income and overstated deductions.

Senator MOYNIHAN. Would you help me just once more? Is it income not reported or taxes not paid?

Mr. PEARLMAN. It is taxes not paid on unreported income.

Senator MOYNIHAN. Yes. So it's about a 10-percent loss.

Mr. PEARLMAN. Yes. Well, a little more than that.

Senator MOYNIHAN. Does the OECD ever make estimates of this kind?

Mr. PEARLMAN. Senator, I don't know the answer to that question. I just don't know if other countries do that or not.

Senator MOYNIHAN. We are one of very few countries that have a self-assessing tax system, aren't we?

Mr. PEARLMAN. Well, there are other countries that claim they have a self-assessment system, but let me say that other countries just marvel at the efficiency of our self-assessment system. Every time we meet with tax officials in other countries, they are amazed at the level of compliance in this country. And, very frankly, I think that's why many of us want to make sure that our system is preserved, because we see what happens in other parts of the world when it is not.

Senator MOYNIHAN. I think it's worth noting that the British revenue agency, Inland Revenue, has almost as many employees as the IRS, in order to collect taxes from a population that is less than one-third that of the United States.

Two quick questions. In the last 4 years, the Tax Code, if I am not mistaken, has almost doubled in length or at least in complexity. Isn't that right?

Mr. PEARLMAN. The Tax Code has grown dramatically in the last 4 years.

Senator MOYNIHAN. Could I get an estimate from you, Mr. Pearlman? You know every word of it. You have written half of it.

Mr. PEARLMAN. I can't confirm that it has doubled.

Senator MOYNIHAN. You are not under oath. If I said it had about doubled, does Buck Chapoton——

Mr. PEARLMAN. You would not be too far off.

Senator MOYNIHAN. I would not be too far off. If a historian of this period, given no clues as to the political identity of the party in office, said there was a 4-year period when the Tax Code doubled in the amount of regulation, exaction, burden, complexity, and bureaucratic rule, expanded to an exponential length, would he have chosen—let's see, what administration? What party would he have thought to be in power? [Laughter.]

Don't answer that.

There was a moment during our consideration of the last tax bill—Mr. Chairman and Mr. Long will remember—at about 10 at night when we were pretty weary. We realized we had about 1,000 pages to go, and it turned out to be like 700 printed in the bill already. And Senator Chafee offered a one-line amendment that would have achieved our revenue goal of $150 million over 3 years: 3-year delay of indexation. But Mr. Dole said, "That's a nice amendment, but it is the killer amendment. With one line, we could have reached our revenue objective, but the administration would have none of it." We got six votes.

The CHAIRMAN. Well, that was the ultimate simplification.

Senator MOYNIHAN. Yes. The one-line simplification. But there are some people who just like overgovernment and you can't help it. [Laughter.]

I want the record to show that Mr. Pearlman and I had a very good conversation about section 936, and he is sensitive to a problem we have with that provision. The tax incentives for investment in Puerto Rico that are presently embodied in section 936 have been a part of U.S. policy since 1921. The revenue cost estimate is not small—$1 billion. And Puerto Rico is not represented in this body, yet its people are citizens of this country. And I know that Mr. Pearlman is going to be sensitive to the subject.

Mr. PEARLMAN. Clearly.

Senator MOYNIHAN. And at a minimum you have to understand that this issue has got to be much more closely attended to.

Mr. PEARLMAN. As I indicated to you, Senator Moynihan, we have already had discussions with the government of Puerto Rico and others in Puerto Rico who are interested in this provision. It is a provision that we recognize is a very sensitive one, and will be so treated.

Senator MOYNIHAN. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman.

Mr. Pearlman, let me add my words of support. I am delighted to see you nominated for this position, and certainly will support you in that regard.

Let me get to what Russell Long was talking about for a moment. I saw that network show that said there were 200-some people that paid no taxes; that made substantial amounts of income. I don't know the legitimacy of that, but I would appreciate it if Treasury would develop us a profile—not the names obviously—of how they did it. If it is just municipals, I think they have paid their share by taking the lower return. I think Bill Simon makes a legitimate point there. I'm sorry to see that kind of a result because I think it does—where people don't understand it, it hurts confidence in the system.

But let me know those things that we don't really cover by the alternative minimum. There may be some equipment things in there, but whatever it is, specifically, to see if we can't narrow that number down even more. And it is a small number now when we think about the millions of people that pay taxes, and you are talking about 200 that do not who make substantial amounts of income.

The other point is that it is interesting to me to see the mixed bag on the part of business as to your proposal. I think it is interesting to see the conflict of interest that has developed with some of the high paid executives in our country. They have a salary of a half million or a million dollars and all of a sudden to see their tax go down from 50 to 35 and see their corporation's tax go up, and to see how they resolve that; whose side they get on on the issue.

It's an interesting dilemma that those people are now facing. It may be part of the muted response that we are getting to your proposal.

Now the other problem that concerns me, Mr. Pearlman, is I can't help but remember the eloquence of the Treasury Department and the gentleman who is backing you up at the moment, Mr. Chapoton, when he presented the 1981 act for capital formation. And I was really for it, and you really sold me. And I supported it.

And now I see something quite different from that, something that I am convinced at least in the shortrun is going to deter capital investment; is going to make us less competitive with the Japanese, and we are going to have a $130 billion trade deficit shown here in a little bit. And yet I get some of the peer economists that say, well, in the long run, it's going to work to the better.

I don't know how many years that is, and I can't help but remember one noted economist said in the long run we are all dead. So I'm concerned about the next 5 or 6 years and what happens, and the wave of the modernization of the productive capacity of this country.

And then I hear you say that this is simplification. Simplification. When you index interest rates and when you index capital gains, and when you index depreciation, I don't understand that. When you talk about simplification of capital gains, I had not yet heard anyone talking about the complexities of capital gains in figuring it, and complaining about it. Not one. And I have 16 million people in my State. And the literacy rate has risen to an alarming

level. Almost all of them have learned to write. And they write me. [Laughter.]

But not one complaining about the complexity of capital gains.

Now the one thing a businessman wants is some certainty. And I believe in this period of time while we debate this issue and decide what happens to capital gains, and the ACRS, and investment tax credit, that you are going to see a delay by many in making the kind of investments that we want to help keep the GNP moving and to modernize, again, the productive capacity of this country.

Now tell me how is it when you index interest rates and capital gains and depreciation that that's simplification? You know, a businessman, when he borrows money, and wants to get the cash flow after his taxes to determine how he is going to meet those obligations, and then you put another variable in there—inflation—tell me about it? Why is that simplification?

Mr. PEARLMAN. I hope you didn't hear me say that indexing was simple. I didn't. I thought I said quite to the contrary that I think we did some things in this package that contribute to simplification, but I do not include indexing in that piece. But let me say this.

Senator BENTSEN. Good.

Mr. PEARLMAN. That the complexity of indexing has been overstated dramatically, in my judgment. It is not as complex as people suggest it is. But it is more complex. The indexing proposals simply have to be reviewed. You can accept them or you can reject them on the basis that if you are going to try to fairly tax a person's income, you have got to take inflation into account. There's a price you pay when you do that, and that is to add some complexity to the calculation of a person's tax.

We have heard a number of people indicate, Senator, that it will make business decisionmaking more complex because taxpayers won't know how much interest deduction they will take in a certain year or how much their gain will be.

My experience would suggest that businessmen already take inflation into account; they don't make investment decisions without taking into account the increase in the cost of operating a piece of equipment, the increase in salaries, the increase in utilities. The problem of inflation is already very much a part of business decisionmaking today. When we say to the business community and to individual taxpayers that we want to tax you only on the noninflationary portion of your income we have not, except to the extent of the interest indexing proposal, which disallows a deduction—we have not heard hues and cries from anyone that indexing capital gains which will reduce gains or indexing depreciation which will increase the deduction is unacceptably complex. Indeed, we have received rather positive responses on those proposals.

Senator BENTSEN. Wait till they start figuring it.

Thank you very much.

The CHAIRMAN. Let me follow up on complexity, if I might. And it's imperative—I think you agreed—that the public must perceive of what we are doing as fair.

Mr. PEARLMAN. Yes. I completely agree.

The CHAIRMAN. They must perceive it as fair.

Mr. PEARLMAN. Yes.

The CHAIRMAN. At the moment, we have some statutory employee benefits that are not taxed—health being one. A relatively simple system. The employer contracts with an insurance company, pays them a lump sum and they pay the benefits. If we tax all or part of those benefits, that is going to make the system more complex rather than simple. Right?

Mr. PEARLMAN. Yes. I think it would, yes.

The CHAIRMAN. Second, if the public, the general public, perceives that the taxation of those benefits is unfair, then that meets the test of neither fairness nor simplicity, does it?

Mr. PEARLMAN. Well, that's a tough one, Senator. I would certainly with respect to a taxpayer who tomorrow would be taxed on——

The CHAIRMAN. I don't mean a taxpayer. I mean if you were to just ask the general public the same question that was asked about charitable contributions, do you think health benefits should be taxed—not a taxpayer; the general taxpayers. I have seen an answer to that question. And it's about the same as charitable.

Mr. PEARLMAN. Mr. Chairman, I think wage earners who have the benefit of tax-free health insurance would answer that question as you predicted. They would say that's unfair.

I think we have a responsibility to look at the rest of the taxpayer community, many of whom don't have the benefit of tax-free health insurance premiums. How about the self-employed individual, the sole proprietor? He has to pay for health care. He doesn't get a benefit from a tax-free health insurance.

The CHAIRMAN. He can pay for it for his employees. He just can't have it for himself.

Mr. PEARLMAN. Correct.

The CHAIRMAN. I have long thought that was an absolute unfairness in the system that ought to be changed and the employer ought to be included also. But that's neither here nor there.

I don't want to pursue this because I see Senator Matsunaga has come, and Senator Long is very dutifully waiting here so we can vote.

I'm going to simply ask you—Senator Symms has a question. I will submit it to you in writing, if you would be sure to answer it and give that to him.

Mr. PEARLMAN. Sure.

[The question from Senator Symms follows:]

RESPONSE TO QUESTION FOR RON PEARLMAN FROM SENATOR SYMMS

Question. The Treasury recently issued two sets of regulations concerning the use of cars and airplanes for business and personal purposes. The set of regulations describing automobile recordkeeping rules sparked a public outcry and caused me and many of my colleagues to sponsor corrective legislation. This outcry also caused you to issue a news release just this past Friday promising reduced recordkeeping and clearer, fairer rules in this area. I believe the other set of regulations dealing with the computation of income and how employers must withhold from their employees with respect to such income is equally burdensome and unfair. I have heard complaints about these regulations from ranchers and other businessmen in my state, as well as from such diverse organizations as the League of Cities, Department of Defense, and the National Association of Manufacturers.

All of this signals to me that this Committee needs your commitment to issue new regulations containing rules that are clearer and fairer. I would appreciate it if you would commit to work with me and my staff and other interested members of this

Committee to develop these clearer and fairer rules. I think such new rules should be issued promptly, probably in a news release. Will you give us such a commitment? If not a legislated moratorium may be necessary.

Answer. The regulations to which you refer were issued on a priority basis to give employees and employers guidance on what steps they should take to comply with changes enacted as part of the Deficit Reduction Act of 1984 relating to the use of automobiles, airplanes and certain other property for both business and personal purposes. You are correct in pointing out that these regulations prompted a swift and vocal response from a number of affected taxpayers. We have attempted to repond to the legitimate concerns that were voiced in this process by issuing, again on a priority basis, additional regulations which clarify taxpayers recordkeeping obligations and also provide special rules which will eliminate the recordkeeping requirment in certain situations where general patterns of use exist. We will continue to review these recordkeeping regulations and we will be reviewing the fringe benefit regulations with a view to improving the clarity and fairness of each set of regulations. We would be happy to meet with members of the Finance Committee and their staffs as well as other interested parties to discuss the issues raised by these regulations, as input from all sources will be helpful to use in developing workable regulations in this area.

The CHAIRMAN. Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman. To save time, I will submit my questions in writing.

[The questions from Senator Matsunaga follow:]

RESPONSES TO QUESTIONS FOR RON PEARLMAN FROM SENATOR MATSUNAGA

Question 1. Deputy Assistant Treasury Secretary McLure, who is viewed as one of the chief architects of the Treasury tax reform plan has argued that the current tax system distorts business decisions by encouraging uneconomical investments and discouraging productive investments. Under this view, the elimination of most of the current investment incentives would encourage productive investments and increase economic growth. In contrast, there is some concern particularly among economists that the elimination of a number of the current investment incentives such as the investment tax credit would result in a drop in investment and economic output. Would you please give your views on this debate?

Answer. Under current law various types of income can be treated quite differently, depending on how the income is earned and how it is spent. Such a tax system clearly distorts economic decision-making, including investment decisions. The most extreme cases involve tax shelters in which it is possible to earn a handsome after-tax return from an investment that has a low or even negative before-tax return. In less extreme cases we find over-investment in lightly taxed activities and under-investment in activities that pay tax at or near the full statutory rate. These distortionary effects result from such features of the tax law as the investment tax credit, the failure to provide indexed real economic depreciation allowances, the full deductibility of all interest expense, regardless of the amount of inflation premium it includes, and the double taxation of corporate dividends. Allowing the tax system to distort the allocation of the nation's resources in this way does not make good economic sense. Our proposals would reduce, if not eliminate, most of these distortions and allow market forces, rather than tax considerations, to determine what businesses produce, and how.

Most economists who speak about reductions in investment concentrate on effects on a limited part of the economy, those that would lose preferential treatment. Of course, many industries would benefit from such provisions as the deduction for half of dividends paid, indexing of inventories, lower tax rates, and the reduction in interest rates that would result from interest indexing. Our discussions with the economic forecasting firms indicate that they have not modeled all these favorable provisions, or have not modeled them appropriately. In addition, it is widely recognized that these macro-models are inherently incapable of fully capturing the effects of fundamental changes in tax structure and the improvements in the quality of investment a more neutral tax system would produce. In summary, we believe that our proposal is pro-growth, and will not hurt investment, but in fact will greatly improve productivity of the investment that takes place.

Question 2. As you are well aware, the tax code has been used as a vehicle for providing incentives for businesses to provide benefits to employees particularly in the pension and health fields. On this committee, there are those who argue that as long as the employee benefit program does not discriminate in favor of high echelon

employees and serves a useful social purpose, the tax code is the appropriate vehicle for providing incentives for such a benefit. In contrast, others assert that the tax code should not be used as a vehicle for social engineering particularly in light of the revenue loss occasioned by the tax free status of many of the employer provided fringe benefits. Would you outline the circumstances under which you feel the tax code can and should be used to provide incentives to employers to provide employee benefits to employees?

Answer. We believe, as a fundamental principle, that to the extent possible and barring conflicting objectives, all income should be taxes uniformly and consistently. That implies that fringe benefits provided by employers should not be taxes any more favorably than if the same item of consumption were provided by the employee with after-tax funds. We must, however, take account of practical realities. In some cases it may simply not be feasible to value a fringe benefit and allocate it among individual employees. In other instances, a case can be made for allowing a minimum level of service to be tax exempt. That type of consideration motivated our proposal to tax premiums on employer provided health benefits only to the extent they exceed $70 per month for a single person and $175 for a family. We felt we could not propose eliminating entirely the tax advantage of employer provided health benefits, despite the equity argument for doing so. In most other cases, however, we believe that grave inequities among workers and distortion in economic decision-making outweighed other considerations.

Question 3. Recent studies have placed the net savings rate in the United States at roughly half of the average of other major industrialized countries. According to prominent economists such as the former Chairman of the Council of Economic Advisers, Dr. Martin Feldstein, budget deficits are absorbing virtually all net private savings and are outweighing the favorable effects of tax incentives for greater saving and investment. Do you perceive the same connection between budget deficits and private savings?

Answer. I believe I really should defer to the economists on that one. I really is not my area of expertise.

Senator MATSUNAGA. I just congratulate you, Mr. Pearlman, upon your appointment. And I take it that you will more or less be doing what Secretary Chapoton used to do. Is that correct?

Mr. PEARLMAN. I'm going to try.

Senator MATSUNAGA. I mean the position.

Mr. PEARLMAN. The position is the same.

Senator MATSUNAGA. We will be seeing plenty of you.

The CHAIRMAN. Senator Bentsen, any further questions?

Senator BENTSEN. No.

[Whereupon, at 12:32 p.m., the hearing was concluded.]

[Additional material received for the record:]

National Association of Home Builders
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Peter D. Herder
1984 President

1985 JAN 29 PM 1:39

January 21, 1985

Honorable Bob Packwood
Chairman
Senate Finance Committee
219 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the 130,000 members of the National Association of Home Builders, I am writing to express our unqualified support for the nomination of Richard G. Darman as the Deputy Secretary of the Treasury. We have been able to observe Dick Darman in his current capacity as Assistant to the President and Deputy to the Chief of Staff. He has shown himself to be highly capable, loyal, and accessible to members of the business community.

Mr. Darman has had a very distinguished career both within and outside the Federal government. He has served in key policy positions in five Cabinet Departments, was a faculty member of the Harvard University Graduate School of Government, and a partner in a major management and economic consulting company. He brings a great depth of experience to the important position of Deputy Secretary of the Treasury. As important, he is an essential link in the Baker/Darman team which has served the President so ably over the past four years.

I respectfully request that this letter be made a part of the record of the confirmation hearings for Mr. Darman before your distinguished Committee.

Sincerely yours,

Peter D. Herder

Peter D. Herder
President

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